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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 95/82

10:00 a.m., September 6, 1995

Contents

Executive Board Attendance

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

Executive Directors	Alternate Executive Directors
	A. A. Al-Tuwaijri
M.-A. Autheman	A. Fayolle
	P. Cailleteau, Temporary
	D. Desruelle, Temporary
J. Bergo	
L. E. Berrizbeitia	J. Guzmán-Calafell, Temporary
	A. Galicia, Temporary
I. Clark	G. F. Murphy
	C. K. Duenwald, Temporary
B. S. Dlamini	T. Berrihun, Temporary
H. Evans	J. Shields
	A. G. Cathcart, Temporary
K. P. Geethakrishnan	W. Hettiarachchi
	L. M. Cheong
D. Kaeser	
A. Kafka	A. Calderón
	J. C. Estrella, Temporary
W. Kiekens	J. Prader
	D. Daco, Temporary
	M. Nemli, Temporary
Y.-M. T. Koissy	H. A. Barro Chambrier
G. Lanciotti	N. Coumbis
K. Lissakers	B. S. Newman
	M. W. Ryan, Temporary
H. Mesaki	
A. Mirakhor	M. Daïri
C. Saito	A. G. Zoccali
	B. Esdar
	R. J. Heinbuecher, Temporary
A. S. Shaalan	Y. Y. Mohammed
	A. V. Mozhin
	A. Vernikov, Temporary
E. L. Waterman	J.-H. Kang
	O. Havrylyshyn
Zhang Z.	Wei B.
	Song J., Temporary

L. Van Houtven, Secretary and Counsellor
A. Mountford, Acting Secretary
S. Bhatia, Assistant
R. Bradshaw, Assistant

Also Present

IBRD: J. Macgregor, Middle East and North Africa Regional Office; F. D. McCarthy, Office of the Vice President Development Economics. African Department: E. A. Calamitsis, Director; C. Brachet, Deputy Director; J. A. Clément, P. Dhonte, S. N. Kimaro, F. C. Ribe, R. C. Williams. Central Asia Department: Y.-R. Kim. European II Department: J. Odling-Smee, Director; M. Shadman-Valavi. External Relations Department: P. J. Bradley, J. Starrels. Fiscal Affairs Department: E. de Callatay, L. U. Figliuoli. Legal Department: R. H. Munzberg, Deputy General Counsel; H. Elizalde, J. L. Hagan, Jr., J. K. Oh, D. E. Siegel. Middle Eastern Department: P. Chabrier, Director; M. D. Knight, Deputy Director; S. Eken, E. Maciejewski, A. H. Mansur, A. Mazarei, C. J. McDermott. Monetary and Exchange Affairs Department: V. Sundararajan. Policy Development and Review Department: J. T. Boorman, Director; M. Allen, Deputy Director; T. Leddy, Deputy Director; R. M. Brooks, B. Christensen, J. W. Decressin, M. Fisher, H. M. Flickenschild, N. L. Happe, S. Y.-L. Jen, K. J. Langdon, A. K. McGuirk, J.-C. Nascimento, M. A. Tareen. Research Department: P.-R. Agenor. Secretary's Department: W. S. Tseng, Deputy Secretary; K. S. Friedman. Treasurer's Department: D. Williams, Treasurer; G.Wittich, Deputy Treasurer; J. E. Blalock, J. C. Corr, E. Decarli, D. M. Hicks, B. A. Hindawi, G. Jonsson, S. T. Lurie, G. S. Markosov, F. M. Meek, P. R. Menon, I. Otker, M. Papaioannou, N. L. Wagner. Office of the Managing Director: S. Sugisaki, Special Advisor; G. R. Saunders, Personal Assistant; C. S. Lee. Advisors to Executive Directors: J. M. Abbott, M. A. Ahmed, M. Alemán, B. Andersen, R. F. Cippa, S. S. Farid, S. K. Fayyad, T. K. Gaspard, J. Justiniano, R. Kannan, M. F. Melhem, S. N'guiamba, T. Oya, K. Sundara. Assistants to Executive Directors: S. Al-Huseini, R. D. Bessone Basto, P. I. Botoucharov, M. A. Brettschneider, A. L. Coronel, J. Dagustun, S. Fukushima, C. M. Gonzalez, B. Grikinyté, A. Guennewich, J. Hamilius, O. Himani, Huang X., G. H. Huisman, H. Kaufmann, W. C. Keller, A. M. Koulizade, E. Kouprianova, K. Kpetigo, G. A. Kyriacou, N. Laframboise, J. A. K. Munthali, Ng C. S., H. Petana, G. P. Ramdas, S. Rouai, K. Sakr, F. A. Schilthuis, S. Simonsen, Y. Tahara, R. von Kleist, E. Zamalloa, Zubir bin Abdullah.

1. JORDAN - 1995 ARTICLE IV CONSULTATION; AND REVIEW UNDER EXTENDED ARRANGEMENT

The Executive Directors considered the staff report for the 1995 Article IV consultation with Jordan and the third review under the extended arrangement (EBS/95/140, 8/16/95). They also had before them a background paper on selected aspects of adjustment and the growth strategy in Jordan (SM/95/218, 8/29/95).

The staff representative from the Middle Eastern Department made the following statement:

> This staff statement reviews observance of quarterly performance criteria for end-June 1995, developments in domestic interest rates and gross official foreign exchange reserves, and the latest macroeconomic developments.
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> Jordan observed all performance criteria for end-June 1995 under the extended arrangement (see Annex). Net claims on the public sector by the domestic banking system increased by JD 10.9 million during the first half of 1995, compared with an adjusted ceiling of JD 76.6 million, after taking into account payments associated with external debt buyback and restructuring operations (JD 1.6 million). The increase in net claims on the public sector by the banking system was solely attributable to an increase in claims on public enterprises (JD 21.5 million), while net claims on the central government declined by JD 10.6 million.
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> The increase in the net domestic assets (NDA) of the Central Bank of Jordan (CBJ) during the first half of 1995 (JD 68.7 million) was substantially below the corresponding program ceiling (JD 106 million). The indicative target for reserve money was also observed comfortably.
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> The net international reserves (NIR) of the CBJ declined by US$39.6 million, compared with a build up of US$42 million targeted under the program. However, after adjusting for the shortfalls in external financing during the first half of the year, the level of NIR of the CBJ remained significantly above the adjusted floor for end-June 1995.
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> The interest rate on 3-month Jordan dinar (JD)-denominated certificates of deposit (CDs) increased by 0.8 percentage points to 8.5 percent by late August from its end-December 1994 level; the corresponding increase in the interest rate on the 6-month CDs was 0.9 percentage points to 8.75 percent. Interest rate levels significantly exceeded the corresponding U.S. treasury bill rates and the annualized domestic inflation rate based on consumer price data for the 12-month period ending June 1995 (see below). The differentials between the interest rates on JD-denominated assets

and U.S. dollar-denominated assets increased further to 3.0 percentage points for 3-month JD-denominated CDs and to 3.3 percentage points for 6-month CDs. The latest data indicate that the usable gross foreign exchange reserves of the CBJ increased moderately (US$60 million) in recent weeks, reflecting more attractive interest rates and the seasonal pickup in inflow of workers' remittances. However, at US$425 million (1.4 months of imports), the level of gross official reserves remains low compared with the program target of US$591 million (2.1 months of imports) by end-December 1995.

The latest available data also suggest that Jordan's macroeconomic performance in terms of economic activity, inflation, fiscal operations, exports and imports remains on track. Inflation (as measured by the consumer price index) was 2.1 percent over the last 12-month period through June 1995; this compares with a revised (lower) inflation program target of 3.5 percent for 1995 as a whole.

Export receipts, import payments, and inflows of workers' remittances have remained in line with the program projections. Workers' remittances (including transfer of savings) rebounded by 22 percent during the first half of 1995, compared with the low level of inflows recorded during the corresponding period in 1994.

Mr. Shaalan made the following statement:

Over the period since last February, when the second review under Jordan's extended arrangement was concluded, the Jordanian authorities have continued to build on the solid progress they achieved in recent years in the areas of macroeconomic stabilization and structural reform. Reflecting this progress, it is now expected that macroeconomic performance in terms of growth, inflation, and external current account adjustment will be better than initially envisaged under the program for 1995. The current account adjustment, in particular, has been quite impressive as, following a sharp reduction in 1994, the deficit is now projected to decline further to 5 percent of GDP in 1995, compared with the earlier program projection of 8 percent.

Firm demand management policies have contributed in an important manner to the observed improvement in the external sector, and they continue to be the key element of the authorities' overall strategy for achieving further improvements in 1995 and beyond. The fiscal deficit (excluding grants) is now projected to decline from 5.9 percent of GDP in 1994 to 4.6 percent in 1995. While this is somewhat higher than the original target of 4.3 percent, the primary balance is now expected to be better in 1995 than initially programmed. That the projected budgetary improvement in 1995 represents a substantial fiscal tightening, and a correspondingly large reorientation of resources away from domestic absorption, becomes readily clear when the magnitude of the envisaged adjustment is evaluated against the backdrop of the adverse effect of exogenous developments on interest payments on foreign debt. Specifically, reflecting higher world interest rates and the depreciation of the U.S. dollar vis-à-vis other major currencies, external interest payments are now expected to exceed initial program projections by 1.1 percent of GDP.

Monetary policy will continue to be guided by the need to ensure domestic price stability and geared toward maintaining the attractiveness of Jordan dinar-denominated financial assets. In line with this overall policy orientation, and in view of the lingering uncertainty emanating from the possible future redemption of Jordan dinars circulating in the West Bank and Gaza Strip, the monetary growth rate is now expected to be limited in 1995 to well below the originally targeted monetary growth rate and the projected nominal GDP growth rate. The Central Bank of Jordan will also continue to seek to maintain adequate interest rate differentials in favor of Jordan dinar-denominated assets vis-à-vis U.S. dollar-denominated assets of comparable maturity. It may be noted in this regard that reflecting a combination of a recent upward adjustment in domestic interest rates and a decline in the U.S. dollar rates, these differentials now stand at 3.0-3.3 percentage points, compared with 2.3-2.5 percentage points at the time of the second review.

The strengthening of the macroeconomic policy stance in 1995 is being accompanied by a substantial intensification of the structural reform effort. A major reform of the direct and indirect tax systems is expected to be approved by the Parliament later this week, and legislative approval of a draft investment law, which is aimed at substantially rationalizing the incentive structure, is expected to follow shortly thereafter. These reforms represent an integral element of an overall strategy that is aimed at enhancing the supply potential and outward orientation of the Jordanian economy. Consistent with this strategy, the authorities intend to build on the substantial progress achieved in recent years in liberalizing the trade regime. To this end, they are currently holding discussions with World Bank staff, with a view to introducing further significant improvements in the tariff regime soon.

Jordan's adjustment and reform effort continues to be carried out in the context of continuing market apprehension about the country's capacity to attain balance of payments viability and uncertainties regarding future currency arrangements in the West Bank and Gaza Strip. It may be recalled that at the time of the second review under the extended arrangement, I highlighted, in parallel with an excellent staff presentation on the subject, the importance of external financial support to effectively address Jordan's debt overhang and meet its need for a stepped-up pace of reserve accumulation. These issues, which continue to be of utmost relevance, are once again appropriately highlighted in the staff report before us. I fully agree with the importance attached in the staff report to addressing Jordan's critical needs in both of these areas. I shall, therefore, only add the following brief comments.

Since the time of the second review, a major step toward reducing Jordan's heavy external debt burden was taken with the recent approval by the U.S. Congress of the full amount of debt reduction announced earlier by the Administration. In view of the large magnitude of the remaining debt burden, it is hoped that this highly welcome step will be followed by a broad-based participation in the debt restructuring effort and that the resulting reduction in the debt burden will be sufficient to effectively address Jordan's debt overhang.

As to the adverse effects of the uncertainties emanating from the future currency arrangements in the West Bank and Gaza Strip, it is clear that the persistence of these uncertainties calls for a significantly larger buildup of gross official reserves than that originally envisaged under the program. This will be necessary if Jordan is to be able to effectively overcome the prevailing unfavorable market perceptions regarding its ability to deal with the contingent liability associated with the Jordan dinar holdings in the West Bank and Gaza Strip. However, with these holdings estimated at about US$500 million, it is also clear that an additional reserve buildup of this order of magnitude is well beyond Jordan's capacity to generate on its own in the short run. Indeed, by undermining confidence in the prospects of continued stability of the Jordan dinar, the persistence of this uncertainty is severely hampering the authorities' effort to build up gross official reserves even to the originally programmed level. This may well have already generated a vicious circle, with the prevailing low level of reserves itself acting to impede the reserve buildup effort. Thus, in order to break away from this trap, Jordan's present difficulties call for an additional infusion of external financial assistance, which, in view of the country's heavy debt burden, would need to be on appropriately concessional terms.

Finally, I wish to, once again, convey to the Executive Board, management, and the staff the authorities' deep appreciation for the Fund's continued strong support for Jordan's adjustment and reform effort.

Mr. Mirakhor made the following statement:

As the staff's paper and Mr. Shaalan's statement for the third review under the extended arrangement indicate, Jordan's macroeconomic performance and policy implementation continue to be impressive. The sustained pursuit of prudent demand management policies and the ambitious program of structural reforms have contributed to rapid economic growth led by exports and a strengthening of the external position in an environment of low inflation. Indeed, macroeconomic performance in terms of growth, inflation, the current account adjustment, and the primary fiscal balance are expected to be better than initially envisaged under the program for 1995, with the projected adjustment on the fiscal position being particularly strong when judged against the pressures on the budget arising from adverse exogenous developments. Measures in the structural area have also been given renewed impetus with legislation relating to the tax system and the opening up of the economy, presented to Parliament for approval. In short, Jordan continues to build on and make determined progress in macroeconomic stabilization and structural reforms in line with the framework of policies envisaged under the extended Fund facility.

Despite these encouraging developments, the Jordanian economy is clearly not yet out of the woods. While the authorities' accomplishments have indeed been impressive, they continue to fight an uphill battle against the risks associated with a heavy debt burden and uncertainties emanating from regional developments. If left unaddressed, these elements could pose an increasing strain on the conduct of economic policy-making, risk undermining social and political support for the reform effort, and hinder meaningful and substantive progress toward external viability.

In the immediate term, there is a need for the authorities to press ahead with the task of macroeconomic stabilization and to reinforce this effort with a substantial intensification of the structural reform program. We welcome the authorities' commitment to restore the pace of fiscal adjustment, while implementing fundamental reforms aimed at reducing the vulnerability of central government revenues and expenditures to exogenous developments. The comprehensive civil service reform plan and the proposed modifications to the food subsidy program are crucial in this regard.

Monetary policy is expected to remain appropriately tight with interest rates serving as the primary instrument to achieving the authorities' exchange and gross reserve targets. The staff may wish to comment on the sustainability of high interest policy and whether the balancing of this policy with low inflation target will at some point strain real sector development.

In the structural area, the actions that are contemplated--in the area of the GST, a reform of the corporate and personal income tax, the new investment law and tariff reform--are both bold and substantive and are consistent with the authorities' private sector and export-led strategy of development. It is hoped that the package will be passed by Parliament soon and implemented with resoluteness and determination. As the staff notes, an intensification of the structural reform effort is an essential complement to the need to accelerate disbursements of the balance of payments support from policy-based loans and to stimulate other private capital flows.

However, as we noted during the last review, even under the most favorable scenario regarding the strength and timing of the adjustment and reform efforts, Jordan's economy will continue to be suppressed by uncertainties associated with two issues of special concern. The first issue is the low level of gross official reserves when set against the uncertainties related to future currency arrangements in the West Bank and Gaza Strip and the need to augment these reserves to provide a cushion against the contingent liabilities. We agree that, given the present tight stance of macroeconomic policies, it would be unreasonable and imprudent to expect the economy to generate this additional reserve buildup through a further intensification of its economic policies. The room for maneuver on this score appears to be fully exhausted. And, as Mr. Shaalan rightly remarks, the very fact that markets remain skeptical regarding Jordan's ability to deal with the contingent liability arising from the holdings in the WBGS makes the task of reserve buildup twice as difficult. We would, therefore, once again urge major creditors to help Jordan break through from this trap by extending additional financial resources for reserve supplementation on appropriately concessional terms.

The second issue relates to addressing market concerns about the economy's capacity to achieve a balance of payments viability with acceptable levels of growth, per capita consumption, and employment. Here again the persistence of the uncertainty weakens the authorities' efforts to proceed toward external viability and to perpetuate the country's dependence on exceptional financing. The staff's updated medium-term scenario points to a situation in the out years which is not sustainable. This leads us to reiterate out statement in the last review that no lasting solution to Jordan's external situation would be possible unless a meaningful and durable solution is found for the country's large debt overhang in the context of a comprehensive debt restructuring operation that results in a substantial and permanent reduction in debt service payments. Given Jordan's excellent track record of policy implementation, we believe that it remains fully deserving of further, substantive debt restructuring in an amount that would be sufficient to alter market perceptions and thereby bolster its prospects for achieving medium-term viability.

Mr. Mesaki made the following statement:

I am pleased to note the authorities' efforts, as described in Mr. Shaalan's statement, to achieve continuous steady growth. It is welcome news that all performance criteria were observed at the end of June this year.

As I agree with the thrust of the staff appraisal, I will make just a few comments for emphasis.

First of all, it is welcome that the fiscal deficit is projected to decline from 5.9 percent of GDP in 1994 to 4.9 percent this year. I hope the authorities will improve the fiscal position as soon as possible by widening the tax base and improving tax elasticity as well as by reducing expenditure.

With regard to structural reform, I commend the authorities' efforts. In particular, I am pleased to note that the tax reform is to be approved by the Parliament this week, and the investment law is expected to follow shortly, as Mr. Shaalan says in his statement. I hope that all the measures described in the staff report will be implemented.

Regarding the gross official reserves, Mr. Shaalan's statement mentions that the authorities are required to build up their official reserves for the anticipated redemption. According to the staff's statement, even though the differentials between the interest rates on Jordan dinar-denominated assets and U.S. dollar-denominated assets, together with the seasonal pickup, increased the official reserves, they are still low, and any further increase owing to seasonal pickup cannot be expected before the end of this year. In this connection, I would like to ask the staff for its comments on the following points.

First, according to Table 9 of Appendix I of the staff report, the redemption of the Jordan dinars will take place in 1998. There is some information, however, which indicates the redemption could take place this year or next. I would appreciate the staff's comments.

Second, given the fact that the current foreign reserves are smaller than envisaged under the program, if the redemption takes place, is there a possibility that the financing gap will be greater than the staff anticipates?

Third, if there is a potential financing gap and the redemption takes place earlier, I would like to ask whether there is a possibility of starting the discussions on the third augmentation under the present program or on the replacement of the program this year.

Fourth, according to the staff paper, the financing gap is expected to expand between 1996 and 2002. Also, the authorities are calling for an additional infusion of external financing assistance, as mentioned in Mr. Shaalan's statement. I would appreciate it if the staff could give us an idea as to how the gap could be closed.

In conclusion, I hope that the authorities will continue to build on the solid progress already achieved in cooperation with the Fund.

Mrs. Cheong made the following statement:

Jordan's performance under its present extended arrangement has been commendable. All of its performance criteria have been observed, growth has remained robust, inflationary pressures seems to be under control, both external and internal imbalances have been narrowing, and significant structural reforms have been initiated. However, despite the progress made by the authorities, the macroeconomic situation in Jordan, particularly its external sector, remains fragile. The current account remains susceptible to exogenous shocks, and difficulties faced in bolstering the low level of gross foreign exchange reserves seem due largely to factors outside the control of the Jordanian authorities.

We note from the background paper that Jordan's fiscal consolidation strategy is based two thirds on expenditure reduction and one third on revenue enhancement. While this strategy has resulted in an impressive reduction of the fiscal deficit from 20.6 percent of GDP in 1989 to 5.9 percent in 1994 (Table 7, page 27 of SM/95/218), further improvements may be possible, particularly on the expenditure side. Current spending on wages has actually increased from 6.5 percent of GDP in 1989 to 6.9 percent in 1994, reflecting a need to both downsize the public sector as well as restrain its wage increases. The share of military expenditure and the public sector wage bill in the overall expenditure has in reality increased from 37 percent in 1989 to 43 percent in 1994, reflecting the fact that expenditure cuts have largely focused on capital expenditure, subsidies outlays, and debt interest payments. We note that civil service reforms initiated in the 1995 fiscal year should permit further expenditure cuts. In addition, we would urge the authorities to ensure that the privatization exercise be used to effectively downsize public sector employment.

The staff report and Mr. Shaalan's statement show that the fiscal deficit is now projected to decline further in 1995, but will remain somewhat higher than the original target. This partly reflects the impact of structural tax reforms which could entail a revenue loss amounting to about 0.5 percent of GDP in the first year. While the staff and the authorities seem confident that such revenue losses will not continue over the medium term, we feel that it would be more prudent to be conservative and provide for some additional revenue losses for the next 2-3 years. This approach will allow for a more realistic targeting of deficit reduction in the medium term while the economy adapts to the new tax measures.

On the balance of payments front, Jordan's efforts at structural reform can be offset by external developments. First, Jordan's current account deficit has narrowed from 19 percent of GDP in 1990 to an estimated 6.5 percent in 1994 (Table 46, page 129 of SM/95/218). However, it still remains very susceptible to exogenous shocks, particularly from the region. The proportion of inward remittances to overall receipts for goods and services in the current account have actually increased from 16 percent in 1990 to 29 percent in 1994. This increased dependence should be a cause of concern, as it was the sudden decline of such remittances from Jordanians in the Gulf states in the mid-1980s that eventually forced Jordan to seek Fund and Bank assistance. Focus of policy should, therefore, be also directed at measures to strengthen the export base and to address the narrow markets, comprising mainly Arab countries. While regional trade linkages are unavoidable, the importance of increased export revenues to facilitate debt servicing and the building up of Jordan's foreign reserves do require extra efforts to diversify sources of export receipts in goods and services in terms of diversification of both products and export markets.

I share the staff's and Mr. Shaalan's concerns that, despite the best efforts by the authorities, the external sector remains fragile due mainly to the debt overhang. Unless and until this overhang is reduced substantially, Jordan will not be able to enjoy the benefits of structural reforms. I would support Mr. Shaalan's call for greater external financial assistance to enable reserves buildup through a reduction in debt-servicing requirements. Cases like Jordan, where the authorities have followed all Fund advice, and yet the economy remains vulnerable because of the debt overhang, should receive more support from the international community, more so when the debt burden is increased by factors beyond the control of the authorities, but due to monetary policy and exchange rate developments in lender countries. The Fund, and the Board in later discussions on debt issues, should examine some modalities whereby borrowers should be freed of at least the portion of the increase in the overall debt due to exchange rate factors outside their control. However, in Jordan's case, such possibilities should not preclude the urgency of bilateral donors initiating further debt relief assistance to enable buildup of external reserves.

I support the staff recommendation to extend the current exchange restrictions and wish the authorities further success in their adjustment efforts.

Mr. Cathcart made the following statement:

Jordan's progress under the EFF continues to be steady. The authorities have demonstrated an ability to adjust policies in response to unforseen developments well, have met the program targets and performance criteria, and continue to be rewarded with reasonable growth with only moderate to low inflation and an abating current account deficit. The main threats to stability come from the vulnerability of the fiscal accounts and the low level of reserves.

On fiscal policy, the deterioration of the overall budget deficit, taken exclusive of foreign grants, represents a setback for the authorities and has rightly merited timely action. Raising the level of the general sales tax to 10 percent shows the resolve of the authorities to take action; I note that this move would put the marginal GST rate at the level originally planned. But current expenditure remains high and I agree with Mr. Mirakhor that the measures envisaged to (1) restructure the system of food subsidies and (2) address public sector employment are also needed. The intended subsidy reform should have the dual effect of reducing the overall level of subsidies through better targeting and reducing the vulnerability of the budget to developments in world food prices through the quicker pass-through of price changes to consumers.

The authorities' plans for tax restructuring are welcome. The widening of the tax base and measures to boost efficiency are particularly welcome. The list of measures listed on pages 13 and 14 is ambitious and the passage of the necessary legislation before the Amman Economic Summit will deserve particular welcome.

The paper contains a good report on the operation of the monetary policy framework and the use of indirect instruments in particular. With the fixed exchange rate policy, interest rate policy is largely governed by the need to avoid reserve losses. That has resulted in the high JD interest rates, and the commitment of the authorities to widen the JD/US$ interest rate differential as needed. That policy will obviously need to continue.

It is welcome that the high interest rate policy does not appear to have impacted adversely on growth and investment, to judge by the comments on page 12. But there are measures, mentioned in the paper, that the authorities could take which would have the effect of reducing the dependence on interest rates. Tighter fiscal policy is one and equalizing the reserve requirements on the Jordan dinar and currency deposits is another.

Let me now turn to Jordan's external position. Developments in the current account of the balance of payments are encouraging; the strong export performance, particularly of non-traditional exports, especially so. Jordan can be expected to benefit from any increased trade flows within the region.

The report highlights the same two sources of reserve pressure as the report for the second EFF review we considered in February, namely, redemption of the Jordan dinar in the WBGS and the medium-term outlook for debt-servicing. Let me discuss each in turn.

The risk of the Jordan dinar redemption is the more pressing issue over the near term. In February, we drew attention to the bilateral understanding reached between the Jordanians and the Palestinian Authority (PA) that the Jordan dinar would continue to be legal tender in the WBGS and that neither party would take unilateral action which could destabilize monetary conditions. We also noted the more active interest rate policy being followed. We thought that these measures would be sufficient to reduce the risk of reserve pressure from this source. Without wishing to underestimate the scale of any potential problem in this area, these observations still apply. Ideally, an agreement with the PA on a phased redemption should be reached, although I note the legal impediments to such an agreement mentioned by the staff.

Moving on to the medium term, the debt overhang issue and associated vulnerability to external developments, particularly flows of foreign direct investment and other private capital flows, continues to exercise the staff and the authorities. I welcome the Fund's analysis of the problem. My authorities remain sympathetic to Jordan's position, as evidenced by our forgiveness last year of all UK ODA debt to Jordan; the United States and some other countries took similar action. Other donors might consider measures within their power to achieve a similar effect. My authorities do, however, consider it too early to reopen the issue of rescheduling debt falling due from 1998 on, especially in view of the generous 1994 Paris Club settlement.

Mr. Ryan made the following statement:

Jordan's real economy continues to show positive movement in a number of areas. Output growth is projected to rise from last year's strong pace. Despite the pick-up in activity, the current account is narrowing and inflation is declining. However, the external position remains fragile, characterized by low official reserves and still large debt-service obligations. These factors, along with regional political uncertainties, continue to weigh on money demand. Absent a credible and durable policy response, the uncertainties created by these factors would likely inhibit investment and foreign financing, undermine growth prospects, and in turn threaten popular support for reforms.

Jordan appears well-positioned to navigate these difficult waters. What is needed going forward are: financial policies that reinforce confidence in the dinar, thereby fostering a virtuous cycle of stronger reserves, reduced risk premiums, and a more sustainable foundation for growth; continued progress on structural reforms to enhance Jordan's competitive position and ability to take advantage of market opening initiatives; and sufficient external support for these efforts. Recent policy actions are generally headed in the right direction. However, Jordanian economic outcomes are highly susceptible to a range of external factors--some of which are quite unpredictable--and this puts a heavy emphasis on getting these policies right and on being prepared to do more if necessary.

WBGS holdings of dinars are a subject of considerable discussion in the paper and cited as a source of uncertainty. There is a range of factors at play regarding market perceptions here--some of which Jordan can control, others to which it must respond. The bottom line would seem to be largely the same, however, in terms of policy approaches. Jordan must keep a tight rein on monetary policy and ensure that interest differentials between dinar and dollar short-term rates reflect shifts in money demand and allows a sufficient risk premium to support a buildup of reserves.

I wonder if the staff could elaborate somewhat on the underlying factors that might influence the future of the dinar on the WBGS as well as their potential implications for Jordan's implementation of the EFF program.

The degree of monetary adjustment required will depend importantly on levels of external support and resulting market perceptions. Foreign financing and external debt relief can complement Jordanian stabilization efforts while also securing scope for a higher level of sustainable growth than would otherwise be possible. Given the impact of Jordan's weak external balance sheet on investment and private foreign inflows, a strong case can be made for further debt relief. Against the backdrop of increased opportunities presented by Jordan's regional and international integration, a comprehensive debt restructuring operation could have a significant catalytic effect in helping Jordan break free of the debt overhang problem. The United States is in the process of completing a full debt forgiveness package for Jordan. We hope others will follow this lead.

Could the staff elaborate on the impact on Jordan's external position of its trade protocol with Iraq?

Continued moves toward fiscal consolidation are necessary to reinforce stabilization and external account objectives along with the associated goal of freeing-up resources for private investment. Progress continues, though not as quickly as targeted. Two key areas requiring particular attention--generalized food subsidies and civil service reform--are well-identified in the staff report. There was also mention of the unfunded liability of public pensions and I wonder if the staff could give some sense of its actual magnitude. The rise in civil service employment and large percentage rise in the wage bill in real terms over the past four years reflect a problematic allocation of resources. Still high unemployment (15 percent) makes downsizing politically difficult, but adding to government payrolls only complicates the required fiscal adjustment and in turn frustrates the achievement of productive, sustainable job creation in the private sector. We are encouraged by more recent actions to contain civil service regarding the comprehensive civil service reform being formulated with World Bank assistance. Also, is there some sense of the size of the unfunded liability of public pensions--an area cited as a prospective source of substantial future budgetary problems?

Revenue collection has been relatively high in Jordan and measures to further streamline and improve indirect and direct tax systems as well as the tariff structure appear well in train. We do have a question regarding the consistency of planned changes in corporate taxes, specifically measures to establish a withholding tax on cash dividends and to limit interest payment deductibility, and wonder about the consistency of that with external objectives. Do increased taxes on returns to capital square with efforts to boost foreign investment inflows?

The faster stabilization objectives are achieved, the more attention can be focused and the more maneuvering room will exist for accelerating action on structural reforms. Some notable progress has been made. The prospective new investment law, trade liberalization, the initiation of negotiations for WTO accession, as well as with the European Union on becoming part of a Euro-Mediterranean Economics Areas, the recent decision to end Jordan's participation in the Arab League Boycott of Israel--all these reflect a more outward orientation. Enhancing Jordanian competitiveness in this environment will require continued market openings and reliance on private sector-led growth. In this regard, the staff papers are largely silent on the question of privatization, and I wonder if the staff could comment on prospects for greater private participation in areas such as utilities.

With these comments, we can support the proposed decision.

Mr. Al-Tuwaijri made the following statement:

The Jordanian authorities should be commended for the continued strong performance of their economy over the past year. This performance could not have been achieved without the authorities' sustained and determined implementation of wide-ranging measures in the context of the EFF program. Preliminary data indicate that both output and inflation were better than programmed. Moreover, the external current deficit declined from 11.6 percent of GDP in 1993 to 6.5 percent in 1994.

These achievements notwithstanding, Jordan's imbalances remain large, and the reform measures taken so far need to be reinforced over the medium term. In particular, further consolidation in the fiscal area and additional progress in structural reform are needed to enhance confidence, encourage private investment, and improve the balance of payments prospects. In this regard, the authorities' plan to reduce the fiscal deficit to 4.6 percent of GDP in 1995 is welcome. Equally important are their efforts to improve the elasticity and transparency of revenues and to enhance the efficiency of expenditures. It is essential, however, that the fiscal targets for 1995 be fully realized and that fiscal consolidation continues along the lines detailed in the medium-term framework. Thus, it is crucial for the authorities to stand ready to implement further fiscal measures quickly, if needed.

On the revenue side, the increase in the General Sales Tax (GST) rate and the rise in some fees and administered prices are steps in the right direction. Moreover, the planned expansion in the coverage of the GST and the reform of the direct tax system should improve the elasticity of the revenue structure.

On the expenditure side, it is clear that the authorities are determined to improve the structure of spending, while maintaining a tight overall expenditure stance. In this connection, their emphasis on reducing current spending by streamlining subsidies and rationalizing the wage bill is appropriate. The planned reform of the civil service, with World Bank support, should go a long way toward achieving this objective. Policies along these lines should enhance the efficiency of expenditures and allow for the savings needed to finance infrastructure investments while maintaining the fiscal consolidation stance.

The improvement in the fiscal picture over the medium term should facilitate the conduct of monetary policy without undermining the authorities' inflation objective. These developments, coupled with the efforts to enhance the transparency and efficiency of Jordan's financial markets, should increase domestic and foreign investments, and improve the external accounts. Nevertheless, as noted in the staff paper and Mr. Shaalan's statement, Jordan's external position is projected to remain vulnerable over the medium term. This vulnerability is due to the country's heavy debt burden and the uncertainties emanating from the possible redemption of Jordanian dinar holdings in the West Bank and Gaza Strip.

Turning to structural reform in other areas, the financial restructuring of the Jordan Electricity Authority should improve efficiency. I also welcome the continued progress in privatizing public sector enterprises.

In conclusion, Jordan's economy is on the right track. The impressive adjustment gains made so far were made possible by the sustained efforts and cooperation of the authorities and the staff. Therefore, I support the proposed decisions and wish the authorities further success in their economic management.

Mr. Song made the following statement:

The Jordanian authorities are to be commended for the progress they have made with their macroeconomic adjustment under difficult circumstances of the past year. The impressive performance under the current EFF has put the economy on a healthy path to further growth and adjustment. I generally agree with the staff on the main thrust of the report and therefore would like to make a few comments on fiscal and monetary policies for emphasis. *Regarding fiscal policy, further efforts are needed to curtail* budgetary expenditure, especially administrative outlays. A restrictive fiscal policy will not only contribute to the stability of market prices, but also to the improvement of external balances. As noted by the staff, interest rate payments on foreign debt and food price subsidies are major factors in the deterioration of the fiscal account. In this connection, it is encouraging to note that corrective fiscal measures will be taken to increase tax rates and reduce budgetary subsidies.

Concerning monetary policy, the sustained policy stance of the monetary authorities will be key a element in the attainment of macroeconomic stability and external viability. The constrained expansion of monetary aggregates has laid down a solid base for safeguarding the stability of market prices and the exchange rate, and the readily provided interest spread for the Jordan dinar assets against foreign investment pertains to the improvement of the external accounts.

In conclusion, I support the proposed decision and wish the Jordanian authorities every success in the future.

Mr. Nemli made the following statement:

I would like to begin by commending the impressive macroeconomic performance of the Jordanian authorities. Real growth is expected to be higher, and the inflation rate and current account deficit lower, than the 1995 program targets, while an increase in domestic savings has allowed for higher-than-programmed domestic private sector investment.

However, various unfortunate external developments beyond the control of the Jordanian authorities have undermined these gains. Higher dollar interest rates and the dollar's depreciation against other major currencies pushed up Jordan's interest payments to higher-than-programmed levels. In addition, higher world prices caused spending on food subsidies to exceed the already high target. Besides these exogenous factors, the import reduction that helped lower the current account deficit also had a side effect on budgetary revenues.

All these circumstances brought a deterioration in the fiscal outlook for 1995. Structural rigidities on the expenditure side seriously limit the authorities' flexibility. Wage-related expenditures on food subsidies account for about 80 percent of the Central Government's current primary expenditures. High defense costs are another source of expenditure rigidities. We believe the authorities' plans for reforming the present food subsidy program are realistic. The new system, which will pass on price changes to consumers while protecting low-income households by means of direct cash transfers, should enable the Government to contain its subsidy expenditures. At the same time, using part of the resultant budgetary savings to finance direct cash transfers to low-income groups will improve income distribution. Moreover, as the staff notes, such a system should prevent smuggling of the subsidized products.

The vulnerability of Jordan's economy to external shocks is not limited to the fiscal sphere. The external balance, despite a significant strengthening of the current account position, also remains fragile. The low level of growth of official reserves reflects shortfalls in the disbursement of external financing and the private sector's preference for holding foreign assets. There is nothing in the relatively low inflation rate, the stability of the exchange rate, and other favorable domestic macroeconomic conditions to make asset holders prefer foreign assets over Jordanian dinar denominated assets. The cause is more likely external, rooted in uncertainty about the possible redemption of dinars circulating in the West Bank and Gaza Strip.

Jordan's high medium-term debt and debt-service payments also threaten the economy's external viability. The low level of foreign exchange reserves feeds this preference, creating a vicious circle. The persistently low level of foreign reserves, in the face of a significant improvement in the current account position, underlies the importance of continued fiscal consolidation for regaining a viable balance of payments position in the medium term. But, in the short term, the room for further fiscal tightening will be limited. This leaves a continuation of tight monetary policy with attractive domestic interest rates as the primary instrument for achieving the goal of increasing reserves. The Central Bank of Jordan should continue its practice of keeping differentials in favor of dinar denominated assets sufficiently high or even increasing them. Removing the structural biases against dinar denominated deposits and maintaining the peg of the dinar versus the dollar are desirable to improve the attractiveness of the dinar over foreign currencies.

Additional foreign assistance on concessional terms will also be crucial for breaking the vicious circle created by the low level of foreign reserves. We encourage the authorities' efforts toward a comprehensive debt restructuring operation to ensure a substantial and permanent reduction in debt-service payments. The staff rightly recommends retention of the present exchange restrictions, and I approve the proposed decision. We wish the authorities continued success in their efforts

Mr. Heinbuecher made the following statement:

Since I can agree with the thrust of the staff appraisal and the topics raised by other Directors, I would like to address at this stage of the discussion just two issues, which are, in my view, of special importance.

First, the medium-term balance of payments outlook entails substantial financing gaps in the period after the end of the extended arrangement. These gaps are occurring in spite of adjustment policies under three almost consecutive Fund-supported programs over a period of roughly nine years. It is quite disappointing that a viable balance of payments position, which is a primary goal of Fund-supported adjustment programs, is still not in reach.

My second point concerns the current level of public sector employment, which the staff has called excessive, and which poses by its budgetary impact a significant burden on national savings and, in turn, on financing requirements. I welcome that the civil service reform plan is being formulated in cooperation with the World Bank, and would like to learn about progress already made. Furthermore, it is encouraging to read that progress is being made with respect to the food subsidy program, which not only poses another significant burden on the budget, but also has adverse allocational and distributional effects. Maybe the staff can comment if the highly warranted correcting scheme, as pointed out in the staff paper, will be established by the end of this year.

Mr. Desruelle made the following statement:

Let me commend the authorities for their steadfast implementation of the program.

Let me welcome their determination to take further fiscal actions to achieve the deficit target in 1995, to maintain a monetary policy that contributes to the attractiveness of Jordan's documented assets and to pursue the agenda of structural reforms.

The question of the treatment of the external debt issue has been touched upon by many speakers today. As everyone remembers, it was also extensively discussed during our discussion of the second review of the program.

I do not want to repeat all the arguments presented by this chair then. However, let me restate the serious doubts that this chair has with the approach advocated by the staff. We remain unconvinced that projections clearly demonstrate the need for an exceptional DDSR operation. We would like to draw attention to the very significant relief on official debt payments that has been achieved under the standard mode of debt treatment, i.e., Paris Club agreements, as indicated in the staff report on the background paper.

Mr. Galicia made the following statement:

We would like to congratulate the Jordanian authorities for the impressive results attained so far in its program.

Jordan has been performing extremely well under its Extended Arrangement (EA). The firm demand of management as well as the intensification of the structural reform efforts have been the main factors behind the success of the program. In this third review of the EA, we are very pleased to observe that Jordan complied with all performance criteria for end-June 1995. In addition, it is reassuring the authorities' determination to pursue with its macroeconomic stabilization and structural reform.

While Jordan's recent macroeconomic performance has been impressive, the country still has important challenges ahead. These, depend not only of domestic factors but also of external circumstances. In addition to the slight deterioration in the fiscal outlook for 1995, the most important issue confronted by the country, is the possible future redemption of Jordan dinars in circulation within the West Bank Gaza Strip vis-à-vis the continuing low level of gross official reserves. This particular situation can complicate the handling of macroeconomic policy in the future if the country does not find a rapid way to attract investment, combined with a financial external assistance, and a wise restructuring of its external debt. Based in these concerns, I will comment first on the budget, and second on the impact of higher real interest on the domestic sector.

Concerning fiscal policy, we concur with the staff that in order to consolidate the budget, some items in the revenue side should be addressed as soon as possible, like a revision of wages and salaries in the context of the bureaucracy size, as well as revisions in military expenditures and food subsidies. It is evident that the quality of the governments expenditure program suffered as capital outlays were lower than programmed, while the wages expenditures and food subsidies have recently depicted a higher share of the total public expenditures. The authorities commitment to restore the pace of fiscal consolidation is welcomed, but further work on the expenditure side of the budget is warranted. Concerning improved revenue measures, we commend the authorities for the important effort made to enhance the direct and indirect tax system, widening the domestic tax base and improving tax elasticity.

On interest rates, the authorities are committed to a continued tight monetary policy through competitive domestic interest rates; actually the low level of reserves and the possible currency redemption, require this firm policy stance. Nevertheless, assuming a further fiscal improvement in the years ahead, as presented in Table 6 of Appendix I, the impact on interest rates derived from a better fiscal stance will follow one direction--that is lower interest rates--and on the other, the tight monetary policy as the primary instrument to achieving the authorities' exchange and gross reserve target, will be pulling for higher nominal interest rates. With the present levels of low inflation which also mean higher real interest rates, eventually could discourage domestic investment. Like Mr. Mirakhor, we would like to hear from the staff about the implications of this high interest rate policy on the real sector of the economy.

To conclude, it is evident that the structural reform effort in Jordan has regained momentum and the firm macroeconomic stance has been present during the implementation of the program. Notwithstanding these achievements, Jordan's economic viability could be threatened by external shocks related with the eventual redemption of Jordan dinar. To avoid any possible disruption, the country should accelerate the fiscal consolidation trough the implementation of a quality criteria on the budget's expenditure side. In addition, as Mr. Shaalan mentioned in his statement, Jordan's present difficulties call for an additional infusion of external financial assistance. We welcome the effort made by the authorities to obtain further debt restructuring/relief and additional financing under concessional terms. We expect a good response from the creditor/donor community.

The staff representative from the Middle Eastern Department stated that the currently high interest rate policy should be viewed as a short-term instrument used to enhance the attractiveness of Jordan dinar denominated assets, with a view to keeping the nominal exchange rate stable, which in turn was necessary to bolster confidence in Jordan dinar-denominated assets. Once reserves had reached a level consistent with the targeted objective for the end of the year, or the end of the program under the extended arrangement, the authorities would probably reconsider the interest rate policy, especially if there were indications--which had not yet appeared--that continued high interest rates might impact adversely on growth and investment. Given the continued external competitiveness of Jordan and good performance of the current account, that policy stance was appropriate for the present time.

In the context of reserves policy, the staff and the authorities were concerned, as were Directors, about the timing of the possible redemption of Jordan dinars held by West Bank residents, which was estimated to be as much as half a billion U.S. dollars, the staff representative stated. A significant possibility also existed of currency substitution, or a shift away from the Jordan dinar to another currency, such as the U.S. dollar, which was widely used in the region--something that had already happened on a smaller scale, about $300 million (part of which had been recouped) during April through June of the previous year. A further inducement to currency substitution was the preference of West Bank residents to hold their assets in U.S. dollars or other strong currencies in order to better preserve the wealth in real terms.

A second problem associated with the huge amounts of Jordan dinars in use in the West Bank derived from a 1994 protocol between Israel and the PLO on economic relations, the staff representative added. The protocol envisaged that a mutually agreed-upon Palestinian currency could be issued at some undetermined future time, subject to further negotiation. Once the decision to issue the currency had been taken, the redemption issue would have to be handled.

The staff and the Jordanian authorities had been aware of these uncertainties and, in the design of the program, allowance had been made to address them, the staff representative explained. However, current levels of foreign exchange reserves--about $420-425 million, or 1.2-1.3 months of imports--were dangerously low to cover a sudden move from Jordan dinars into U.S. dollars. The authorities were determined to pursue their overall policy stance, but could exert only limited influence unilaterally. The low level of reserves and the persistent threat of substitution or uncontrolled currency redemption were probably influencing market perceptions and investment decisions adversely. The issue was, in many respects, well beyond the authorities' control.

An early and rapid buildup of gross official reserves--over and above the program targets for 1995 and afterward--would help calm the situation, the staff representative said. An increase of $300-350 million, in the context of the $500 million worth of dinars held by West Bank residents, would probably suffice to prevent a sudden, disorderly run on U.S. dollars, while instilling the degree of popular confidence needed to support the Jordan dinar. Furthermore, success in removing or stabilizing threats to monetary policy would provide a boost to the structural reform effort.

The staff had indicated, in Table 9 of Appendix 1, a redemption financing need of half a billion dollars in 1998, the staff representative noted. As it was not possible to know when the currency substitution or redemption might take place, the staff had arbitrarily assumed that it would occur before the end of the West Bank's five-year interim period arrangement, which began in September 1993. Under the program, excluding the contingent liability arising from the Jordan dinars held by West Bank residents, the balance of payments for 1995 was fully financed. However, given the low level of reserves, if the currency redemption were to take place sooner than expected, in perhaps one or two months, there would be pressure on the reserves, and the policy response would have to intensify.

In any event, there would be a financing gap, and tighter measures might not be sufficient, the staff representative went on. The need would exist to secure a line of credit or other exceptional financing to close the financing gap, which would arise beginning in late 1997 or 1998. To close it, the authorities would have to scale back the growth targets, which were projected to be 4-5 percent over the medium term, up to the year 2002. However, those rates were already barely sufficient to achieve the program's employment objectives; further reduction would lead to a major deterioration in real per capita income and, consequently, a weakening of the support needed for structural reforms. Clearly, slower growth was not a feasible option. Given the uncertainties surrounding the redemption issue, the authorities might need to reassess Jordan's ability to adhere to the program, particularly for 1996 and beyond. If reserves could be pushed up in the near future, however, market perceptions and confidence would improve, lessening the prospect of a flight from Jordan dinars. In any event, that set of issues would be reassessed at the next review mission, which would take place in November, or even earlier if events made it necessary to resolve the problem.

The financing gap was rising sharply, owing partly to uncertainties about a debt relief arrangement to cover the period after 1998, the staff representative said. What was certain was that external debt-service payments would increase sharply on account of the rescheduled pre-cutoff date. If Jordan were to be able to service its debt obligations in an orderly fashion, it would have to borrow on commercial terms, which would add yet a further burden to debt-service payments. In sum, Jordan presented a case where additional exceptional financing on exceptional terms would unquestionably be needed.

Mr. Mesaki inquired whether there was a possibility of starting discussion soon on the third augmentation under the present program or the initiation of a successor program.

The Deputy Director of the Policy Development and Review Department replied affirmatively to both possibilities. If an unplanned redemption were to take place soon, given the current program's construction, the reserves target was at the lower limit of safety. While the authorities would raise interest rates sharply, that action in itself could affect the implementation of the program and the achievement of its objectives. In such an event, a further augmentation of the arrangement would be considered. The arrangement had been augmented twice already, in light of Jordan's needs for higher reserves and the strength of its adjustment policy. However, Jordan's quota was only SDR 121 million, so the maximum augmentation would still be small compared with the potential size of the redemption problem. In that context, augmentation was only one part of the solution.

The staff representative from the Middle Eastern Department observed that there was also the possibility that, if the Jordanians were to elaborate a new medium-term structural adjustment program, a new arrangement could be considered. In the current circumstances, with the peace process opening new opportunities, with the improvement of Jordan's relations with many of its neighbors, and with the European Union's Mediterranean Basin initiative, it would be possible to base a new program on a major liberalization of trade and investment in Jordan that would lead, in turn, to a strengthening of both inward investment performance and exports. However, there was still the possibility that the persistence of a debt overhang would inhibit external investment, along with export growth.

The trade protocol with Iraq was an important factor in Jordan's external sector performance, the staff representative remarked. Under the protocol, Jordan imported all of its crude oil and petroleum products from Iraq--55,000 to 60,000 barrels per day. Of those, 35,000 were provided under an arrangement of credits that reduced Jordan's cost to half the world market price--a savings of roughly $250 million annually. When viewed against the current reserve level of $380-420 million, the importance of the trade protocol was obvious. Jordan had also been exporting to Iraq pharmaceutical and other essential products, consistent with the U.N. sanctions, which--combined with the credit arrangement--would result in a continued build-up of its net claims with the Central Bank of Iraq.

With regard to the issue of the unfunded pension liabilities, the problem applied only to the public sector fund, the staff representative stated. There did not appear to be a problem with the private pension fund, which was fully funded. Although a technical assistance mission from the Fiscal Affairs Department had worked on the issue for some time, the nature of the problem's cause, and its solution, were not clear. The consequence was obvious, however: total pension contributions amounted to JD 20 million per year, while total disbursements were about 150 JD per year.

On investment and privatization, the question had been raised as to whether the increased taxation of capital was consistent with the attempt to secure additional capital resources. The staff representative from the Middle Eastern Department commented that the measures envisaged by the authorities did not include a tax on dividends, while they did permit the full deductibility of interest payments on a net basis--thereby boosting indirectly the attractiveness of Jordan dinar-denominated assets.

Increased private sector participation in the economy was being encouraged, particularly through the privatization of some aspects of the telecommunications corporation, supported by a World Bank loan, the staff representative explained. Further privatization actions were being discussed between the World Bank and the Jordanian authorities as part of the second tranche of the energy sector adjustment loan. Plans to privatize the Jordanian Royal Airlines were delayed, despite major efforts to organize the commercial base of the company, because the authorities had determined that without a huge capital infusion it was unlikely that privatization could succeed.

Civil service reform was continuing with the assistance of the World Bank, and it was hoped that a number of concrete proposals to improve efficiency would be formulated in connection with the 1996 budget, the staff representative said. At present, new hiring was limited to the health and education sectors, and a new system of promotion and remuneration had been adopted.

The food subsidies scheme had been extensively discussed between the Jordanian authorities and the Fiscal Affairs Department in the context of a technical assistance mission during 1994. A number of proposals were being considered to eliminate the subsidies and replace them with retail pricing for all categories of consumer goods. However, to alleviate the pressures on the poor, the system would be combined with cash payments to the most needy segments of the population. The scheme was expected to be fairly advanced by the fall and possibly could be implemented with the next fiscal budget.

Mr. Shaalan made the following concluding statement:

First, I would like to most sincerely thank my colleagues for the interest they have shown in the discussions today and for their encouraging remarks, as well as their advice. As the staff's answers have been quite comprehensive, I will touch on two or three areas that dominated the discussions.

With regard to the fiscal situation, as noted by many of the Directors, there has been a significant improvement. The authorities intend to continue that improvement. The latest efforts are reflected in the tax reform package that is to be voted on by Parliament and, hopefully, passed this week. This basically includes an upward revision in the GST tax rates--and I will have a little to say on that and the reasons for it--as well as a simplification of the income tax, involving in a reduction in the rates, as well as rationalizing the exemptions that existed in the tax.

The reasons the Jordanians took action to increase the tax on GST are significant, in the sense that there was a fiscal slippage in 1994, on account mainly of exogenous factors. The fact that they took this action reflects their interest in maintaining the integrity of the program by taking corrective actions to address slippages immediately. I should add in this connection that part of the slippage, ironically, resulted from improvements in the structure of the budget. Let me give an example. Jordan has reduced tariff rates quite extensively. This obviously had a negative impact on the budget. They have always in the past taken offsetting measures, and the GST was in part an offsetting measure. While on the budget, I think one of the more important structural changes that have taken place is the increased reliance on domestic taxes, as against taxes on international trade.

Moving to monetary policy, there were some remarks made in relation to redemption policies, a weak reserve position, and the role of interest rate policy. There was some feeling that, maybe, an increase in interest rates should be used to bolster the level of reserves. I am not so sure that we should be using this instrument extensively. Let me say why. The premium over the dollar rates for comparable securities now stands at between 3 and 3.3 percent. But what is more significant is that, with an inflation rate of 2.1 percent for the 12 months ending in June 1995, we have a positive rate in excess of six percentage points. I think any attempt to use interest rate policy to effect further inflows also carries another danger, in that these flows could be in the form of hot money and could easily be reversed, in addition to complicating monetary management in the process.

The last area I wish to touch on, and touched on by most Directors, is on the financing gaps. Mr. Heinbuecher asked a most interesting and important question; namely, after three programs and nine years of adjustment, why are there still financing gaps on the horizon. It is a very good question, and it points to one factor that I think virtually all Directors who spoke mentioned; namely, that debt overhang is a serious problem for Jordan--that, and, of course, the question of the redemption. The Jordanian authorities, in this connection, will consider all options and modalities that may be available to secure the needed financing. They are open to all options. It is the Jordanian authorities' earnest hope that the international community will support them in a comprehensive effort to address these two issues--the debt burden as well as the redemption issue.

The Acting Chairman made the following summing up:

Executive Directors concurred with the thrust of the staff appraisal. They commended the authorities for the continued progress on the macroeconomic front, as reflected in the achievement of high growth, low inflation, and a sharp reduction in the external current account deficit. However, Directors expressed concern that the fiscal situation had weakened in early 1995 and that the level of gross official reserves remained low, reflecting shortfalls in external financing and the private sector's continued preference for holding foreign assets. At the same time, they welcomed the authorities' commitment to restore the pace of fiscal consolidation and accelerate the implementation of a comprehensive and ambitious package of structural reforms geared to the further opening-up of the economy and rationalizing of the incentive structure for the private sector.

While commending the authorities for the substantial reduction in the central government fiscal deficit in recent years, Directors noted the vulnerability of fiscal policy to external shocks and the need for continued fiscal consolidation. They observed that expeditious implementation of corrective fiscal measures for 1995, particularly increasing the basic general sales tax (GST) rate, would be critical in restoring the pace of fiscal consolidation, and they emphasized the need for continued expenditure restraint. In this regard, they welcomed the authorities' intention to replace remaining generalized food subsidies by the end of 1995, while protecting the poor through better-targeted transfer programs.

Directors welcomed the sharp reduction in the external current account deficit resulting from better than expected export performance and lower imports, which were attributable to firm demand management. They also noted that the corresponding lower foreign savings were being offset by increased domestic savings, thereby allowing for higher domestic private sector investment than envisaged under the program. Notwithstanding these favorable developments, Directors observed that in the short term Jordan would need to maintain sufficiently high interest rate differentials in favor of Jordan dinar-denominated assets for the targeted recovery in the gross foreign exchange reserves in the second half of 1995 to materialize. In this regard, they stressed the importance of closely monitoring developments in foreign exchange reserves and, if needed, taking steps to further increase interest rate differentials vis-à-vis US dollar denominated assets. Directors noted that the interest rate policy pursued since July 1994 had not--so far--adversely affected economic growth and private sector investment, which suggested that there was room to continue with the present tight monetary policy.

Jordan's underlying medium-term balance of payments position remains vulnerable to adverse exogenous shocks, including regional developments, swings in private sector sentiment, and movements in foreign interest and exchange rates. Directors also noted the prospect for a redemption of Jordan dinars circulating in the West Bank and the Gaza Strip, the scale and timing of which were difficult to predict. Accordingly, Directors emphasized the need for an early buildup of foreign exchange reserves to a level higher than that contemplated under the EFF program, as a means of reassuring the market and minimizing the potential risk of disruptions to the authorities' adjustment and reform program. Several Directors stressed the importance of a comprehensive debt restructuring operation, to bring about a substantial and permanent reduction in debt service payments, as the most effective way to meet the crucial need to solve Jordan's debt overhang problem and improve its prospects for medium-term balance of payments viability.

Directors commended the authorities for the progress achieved in the formulation of a comprehensive package of structural reforms consisting of amendments to the GST system, a reform of the corporate and personal income tax systems, and a new investment law rationalizing the incentive structure. They also welcomed the authorities' intention to complement this package with a reform of the civil service, further tariff reforms, and ongoing real sector reforms, which they thought should focus on promoting private sector development (including through privatization) and export diversification, both geographically and across commodities.

Directors welcomed Jordan's acceptance of the obligations of Article VIII, Sections 2, 3 and 4, effective on February 20, 1995.

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

The Executive Board took the following decisions:

Exchange Measures Subject to Article VIII

1. The Fund takes this decision relating to Jordan's exchange measures subject to Article VIII, Section 2, in the light of the 1995 Article IV consultation with Jordan conducted under Decision No. 5392-(77/63), adopted April 29, 1977, as amended (Surveillance over Exchange Rate Policies).

2. Jordan retains, as described in EBS/95/140, an exchange restriction evidenced by arrears on certain external debt-service payments that is subject to Fund approval under Article VIII, Section 2(a). The Fund welcomes the authorities' intention to eliminate all external payments arrears by December 31, 1995. In the circumstances of Jordan, the Fund grants approval for the retention of this restriction until December 31, 1995 or the completion of the fourth review under the extended arrangement, whichever is earlier.

Decision No. 11059-(95/82), adopted
September 6, 1995

Review Under Extended Arrangement

1. Jordan has consulted with the Fund in accordance with paragraph 3 of the extended arrangement for Jordan (EBS/94/74, Sup. 3) and paragraph 30 of the memorandum on economic policy of the Government of Jordan attached to the letter dated April 5, 1994 from the Minister of Finance and Customs and the Governor of the Central Bank of Jordan, in order to review progress made in the implementation of the policies and measures described in that letter and annexed memorandum on economic policy of the Government of Jordan.

2. The letter from the Minister of Finance and Customs and the Governor of the Central Bank of Jordan, dated August 12, 1995, shall be attached to the extended arrangement for Jordan, and the letters of April 5, 1994, August 8, 1994, and December 31, 1994 with their annexes shall be read as supplemented and modified by the letter of August 12, 1995 and its attachments.

3. Accordingly, the limits and floor referred to in paragraph 3(a) of the extended arrangement, except for the limits on the net domestic assets of the domestic banking system and the limits on the net disbursement of short-term public and publicly

guaranteed external debt, shall be as described and specified in paragraph 3 of the letter dated August 12, 1995 and Attachments II and III attached thereto.

4. The intention with respect to the external payments arrears specified in 3(b) of the extended arrangement shall be as described in paragraph 7 of the letter dated August 12, 1995.

5. The Fund decides that the third review contemplated in paragraph 3(c) of the extended arrangement is completed, and that Jordan may proceed to make purchases under the arrangement.

Decision No. 11060-(95/82), adopted
September 6, 1995

2. REPORT BY MANAGING DIRECTOR

The Managing Director reported briefly on his meeting with the new Finance Minister of France and the Governor of the central bank. He was reassured by the intention of the French authorities regarding budgetary consolidation. The issue of fiscal consolidation in France would be taken up at the time of the Article IV consultation with France.

3. ENHANCED STRUCTURAL ADJUSTMENT FACILITY - CONTINUED FINANCING AND ADAPTATION; AND POSSIBLE MODALITIES FOR USE OF GOLD IN CONNECTION WITH CONTINUATION OF OPERATIONS

The Executive Directors considered a staff paper on the continued financing and adaptation of the enhanced structural adjustment facility (ESAF) (EBS/95/130, 8/4/95). They also had before them a background paper (EBS/95/135, 8/10/95) and a staff paper on possible modalities for the use of gold in connection with a continuation of ESAF operations (EBS/95/132, 8/8/95).

Mr. Berrizbeitia made the following statement:

The well written staff papers present several issues of great importance to many developing countries, and have significant implications for the future of ESAF. These issues, which relate to access policy under a changing international environment, to eligibility and demand for ESAF resources, to the possibility of an interim ESAF and to a "self-sustained" ESAF, all deserve serious consideration by the Board. I will address each of these issues individually.

Several factors impinge on our consideration of access policy for ESAF-eligible countries and generally point to the need for greater differentiation in access in individual cases. These include the continued prospect of further decline and greater selectivity of bilateral concessional aid flows to developing countries, the increasing emphasis on strong policy performance, the limited overall availability of ESAF resources, as well as the lack of definition regarding an interim ESAF and a self-sustained ESAF, at least for the moment.

In this context, we tend to agree with the staff's conclusions regarding access policy, which, for the sake of brevity, I will not repeat here. However, some additional comments come to mind as a result of a possible decision by this Board to allow greater differentiation in ESAF access policy across countries.

First, it must be ensured that such differentiation is applied in an even-handed manner and, to the degree possible, it should respond to uniform criteria regarding the various differentiating factors identified by the staff. For example, criteria regarding the strength of policies and track records, repeated use of Fund credit, blending of the resources of ESAF and the General Resources Account (GRA) etc., should be the subject of clear staff guidelines.

Second, appropriate differentiation in access policy should not have any bearing on the availability of technical assistance and the provision of continued policy advice, in particular to those countries with reduced potential access to ESAF resources. In our discussion on the role of the Fund, this Chair emphasized the importance of the Fund's technical assistance in support of both of its fundamental activities of surveillance and conditional financing, and I wish to reiterate its importance here, particularly in the context of ESAF-eligible countries.

Third, since it is now a fact that bilateral concessional aid flows are in what appears to be an inevitable decline, with some notable and welcome exceptions, the need to maintain and hopefully strengthen multilateral concessional aid flows acquires even greater importance. Therefore, rapid progress toward establishing *an "interim" ESAF and subsequently a "self-sustained"* ESAF financed through the Special Disbursement Account (SDA) acquires even greater relevance, especially since resources channeled through ESAF, and through other similar multilateral mechanisms, tend to be more "efficient" than bilateral aid, in light of their high degree of conditionality and their greater catalyzing role.

Since eligibility for use of ESAF resources was originally determined on the basis of IDA eligibility, given the need to optimize the use of increasingly scarce ESAF resources it is reasonable to propose the removal from the ESAF-eligible list of those countries that have been removed from the IDA-eligible list.

This seems to be all the more logical since the three countries that would be affected by such a decision have not made use of ESAF resources, nor are they currently requesting the use of such resources. In this context, I look forward to the proposed brief paper, on the circumstances of the three countries concerned.

More generally, however, it could be desirable for the Fund to establish its own criteria for removing countries from the list of ESAF-eligible countries, based not only on per capita income but also on other factors, perhaps similar to those that might be considered for establishing differential access. For example, the combined use of GRA and ESAF resources could be interpreted as a strong indicator of likely "graduation" from the ESAF list.

I have no basis with which to "second-guess" the staff's very reasonable criteria used in estimating potential demand for resources under the current ESAF and during an "interim" ESAF. I, therefore, support such projections as a basis for pursuing our discussions on funding options for an "interim" ESAF.

As regards the financing of an interim ESAF, I understand we face two different yet complementary issues: the source of financing of the loan component and that of the subsidy component.

Referring first to the loan component, I note that the staff considers that the use of new loans provided by bilateral creditors under the existing ESAF trust structure could result in substantial delays in the subsequent introduction of operations under a "self-sustained" ESAF. This suggests that the use of GRA resources may be a more viable alternative for the loan component of the "interim ESAF," especially since new bilateral loans will probably be more necessary to finance the subsidy component of an "interim ESAF."

In this context, and in the light of the estimates for potential demand for ESAF loans on the order of 7.9 billion to 8.7 billion SDRs during the interim period (1999-2004), and of the possible general quota increase under the Eleventh Review, I would *ask the staff to comment on the impact of such potential* requirements of GRA resources on the Fund's expected liquidity position. Also, I wonder whether there would be any specific legal impediments in using them for this purpose, as long as the subsidy component were financed from other sources.

Second, regarding the subsidy component, I think it would be useful to have a brief document on the legal and financial implications, for individual creditors, of the use of SCA-2 resources to cover part of the concessional element of ESAF financing under an interim arrangement. I note, however, that even if the full 1 billion SDR of potential second Special

Contingent Account (SCA-2) resources were to be made available for this purpose, substantial additional resources would be required from bilateral donors, just to meet one-half of the subsidy requirements of the interim ESAF. This is the reason why it seems preferable to concentrate potential new bilateral financing, including the possible use of SCA-2 resources, on the subsidy component.

The other 50 percent of the subsidy requirements would need different sources of financing. Two alternatives have been proposed for this purpose: the early use of resources from the Reserve Account, and the sale of a modest proportion of the Fund's gold holdings.

For reasons that are well explained in the document on "possible modalities for the use of gold," early use of resources from the Reserve Account, even if guaranteed with a gold pledge, would reduce the subsequent availability of SDA resources for a self-sustaining ESAF. Since the basic idea behind an "interim" ESAF is that of a bridging period, until a well funded and self-sustaining ESAF can be established, it doesn't make too much sense to weaken its potential funding during the "interim" period by the early use of the Reserve Account.

For these reasons, my chair supports the sale of a relatively small share of the Fund's gold holdings and the use of the income derived from investing the capital profits of such sale to subsidize up to one half of the subsidy requirements. I understand that this would entail sales of 6.1 million ounces of gold for all ESAF eligible countries, and of an additional 1.5 to 2.7 million ounces taking into account the potential use of interim-ESAF resources by members currently in protracted arrears.

At this point in time, it may be preferable to concentrate on the requirements for an "interim ESAF," before considering the characteristics of a "self-sustaining" ESAF. Nonetheless, some preliminary comments may be in order.

First, for the same reasons previously stated, early use of resources in the Reserve Account is not recommended, since it would imply a lowering of maximum sustainable commitments under a "self-sustaining" ESAF starting in the year 2005. We therefore favor deferring the start of "self-sustaining" SDA financed ESAF operations until 2005, and providing adequate financing for an "interim" ESAF until that time.

Second, I note that, assuming no arrears, the maximum sustainable commitments of an SDA-financed ESAF are of the order of 800 to 900 million SDRs as of the years 2005 and 2006, respectively. I also note that such amounts are lower than the estimated annual requirements of SDR 1 to 1.3 billion during the interim period.

In this context, although it is to be hoped that continuation of the ESAF program will continue to produce impressive results for eligible countries during the interim period, in my opinion it is unlikely that the demand for ESAF resources will diminish substantially during the early years of the next century. We will therefore need to look for supplementary sources of financial support for the "self-sustaining" ESAF in the future. In this respect, I wonder if the GRA resources that would be made available for financing the loan component of the "interim ESAF", could be "recycled" to a self-sustaining ESAF, as prior loans were paid off, thereby contributing to augment the sustainable commitments under the self-sustaining ESAF. Of course, such "recycling" of GRA resources would again entail the need to obtain financing for the subsidy component required for their use under ESAF.

Finally, we do not support the extension of ESAF maturities.

To conclude, I would like to reiterate the importance for donor countries to consider strengthening multilateral concessional aid flows even as they reduce bilateral concessional aid flows in the context of their own progress toward fiscal consolidation. The establishment of an adequately financed "interim" ESAF and, subsequently, an SDA-financed "self-sustaining" ESAF, would go a long way to ensure that sufficient conditional financing will be available for deserving member countries, in the context of appropriately strong adjustment policies. At the same time, this would continue to help these countries in obtaining parallel financing from other sources, given the high degree of conditionality involved in ESAF financing and its substantial catalyzing role.

Mr. Mirakhor made the following statement:

Recent Board discussions on ESAF and reviews of programs under this facility provide two main conclusions. First, ESAF has been helpful in promoting macroeconomic adjustment and structural reforms in low-income countries. Second, in view of the mixed results achieved in the area of external viability and the persistence of difficult external environment, countries need a more realistic timeframe to complete their agenda of reforms. These considerations, combined with the continued need for exceptional financing by low-income countries, lead us to support the continuation of Fund's involvement in low-income countries through ESAF operations.

Beyond these general remarks, our preliminary response to the issues raised for discussion is as follows.

While sharing Mr. Berrizbeitia's comments on access policy and his related remarks on the availability of technical assistance to low-income countries, we support the flexible approach proposed by the staff. The proposal of low access for countries with relatively weak track records seems reasonable. However, we believe that strong performers, even repeated users, should be allowed higher actual access. In addition, although many low-income countries will continue to remain dependent on subsidized ESAF financing, we can support the blending of ESAF with GRA resources for those countries that have the capacity to service nonconcessional debt. This blending could facilitate the graduation of some low-income countries from ESAF financing to more traditional Fund facilities.

We see merit in Mr. Berrizbeitia's suggestion for the Fund to establish its own criteria for preparing a list of ESAF-eligible countries and for removing non-eligible countries from the list. If this is not feasible, we can support the removal from the ESAF-eligibility list those countries that are no longer IDA-eligible or have achieved a sustained improvement in per capita income. Before taking this decision, however, comments from those Directors representing the countries that will be affected by this decision are welcome.

With regard to the current ESAF, we take note of the extension to end-1998 of the commitment period. It is hoped that management and the staff will continue their dialogue with lenders in order to achieve the target amount of SDR 10.1 billion.

The staff presents convincing arguments for delaying the start of a self-sustained ESAF financed from the Special Disbursement Account, and we can support this cautious approach which also has the merit of allowing the Fund to concentrate its efforts on the design of an interim ESAF that would be as successful as the current facility.

On the financing of an interim ESAF, although our preference is for a mechanism similar to the current one with reliance on loans and subsidies from the membership, we can support an alternative mechanism where the Fund plays a financing role through the provision of GRA resources under extended arrangements with interest subsidies financed from the income on the invested profits from modest gold sales. We suggest, however, that the Fund's share in the financing of the interim facility should not exceed that of lenders and donors, in order to safeguard the original nature of the ESAF.

Regarding the use of SCA-2 funds for subsidy, we believe that each individual member should be allowed to make its own decision regarding the use of refunds. In this connection, could the staff give an indication of the amount of SCA-2 resources that could be refunded. We continue to see merit in the use of gold to consolidate Fund's precautionary balances, and to provide subsidy financing to low-income countries. Therefore, we support gold sales and use of the invested profits to subsidize ESAF-type loans along the modalities proposed by the staff. For the same reasons explained in Mr. Berrizbeitia's helpful statement, we are not attracted by the idea of a gold pledge to allow the use of the reserve account resources to provide subsidy.

Finally, regarding the possible extension of ESAF maturities there are two considerations: on the one hand, we are concerned by the heavy debt burden of some low-income countries and, on the other, we share the staff apprehensions regarding the impact of the extension of ESAF maturities on the interim and self-sustained ESAFs, on the financing of subsidies, and on the more general issues of uniformity of treatment, as well as the revolving character of Fund's resources. On the whole, and in view of the adjustment needs of these countries, a succession of ESAF arrangements seems preferable as it would allow countries to maintain closer collaboration with the Fund and deepen the reform process instead of relying on a single ESAF with an extended maturity. However, we encourage the staff to keep the issue of heavily indebted countries under close scrutiny.

Mr. Kiekens made the following statement:

The most recent World Economic Outlook analysis reminds us once again that the international financial community has a strong responsibility to support the domestic policies of the poorest developing countries with adequate transfers of resources provided on concessional terms with appropriate conditionality. The ESAF is a key element in this effort, since it allows the Fund to act as a catalyst in promoting sound policies and mobilizing the necessary financial resources, and it is certain that the need for this form of Fund involvement will continue at least through the medium term. It is therefore reassuring that present ESAF resources appear sufficient to cover its financing needs through late 1998, provided that all creditor countries fulfill the commitments they have made to fund the ESAF's enlargement and extension.

The apparent availability of sufficient resources to cover ESAF's needs for the next few years neither presses us to make hurried decisions on ESAF's future financing, nor eliminates the need to consider how we can improve the activities of this key facility and whether we should make it more permanent.

The staff paper for today's discussion outlines various options for improving or amending the ESAF. Since these proposals will affect the financial resources needed to finance the future activities of the facility, I think we should try to reach agreement on them before turning to financial considerations. The staff's suggestions include a greater differentiation of types of access, the introduction of a stock-taking period between three-year ESAF arrangements, the removal of some countries from the list of ESAF-eligible countries, and the extension of ESAF maturities.

On the access question, I continue to support the principle that higher access under the ESAF could be granted to support significantly stronger policies. I also share the staff's view that aid flows will probably decline and that donors will become more selective in approving financial support. Under such conditions, I believe the existing access limits are appropriate and give the Fund ample room to determine what level of access is needed to help countries undertaking strong adjustment efforts. Flexibility in determining the level of access does not conflict with the principle of equal treatment of members. It is the Fund's duty to use judgment in ranking members by such objective criteria as program strength, capacity to repay the Fund, and whether or not the member has previously used ESAF resources. But greater flexibility should be accompanied by stronger guarantees of objectivity. I therefore also feel that the staff's report to the Board should explicitly justify its evaluation of a country's appropriate level of access to ESAF resources. I also agree with the staff that implementing these principles might, in the future, make average access to the ESAF less relevant in evaluating the implementation of access policies in general.

The suggestion that ESAF and GRA resources be blended for the countries with less need for concessional assistance appears worthwhile at first glance as a means of conserving scarce concessional resources. In practice, however, it would be very difficult to implement fairly on a case-by-case basis, since this would involve a very complex assessment of numerous indicators including the country's income level, its debt level, its ability to service additional debt, or even (as the staff suggests) its quota. All this would greatly complicate the process of negotiation between the staff and the member country. I would therefore restrict such a blending of resources solely to a limited number of ESAF-eligible countries that are clearly in a better position and have a better outlook than most countries in this group.

This issue leads me to the related issue of the removal of countries from the ESAF eligibility list. I feel that the IDA eligibility list is a good indicator of a member's need for concessional resources, and therefore favor removing from the ESAF list any countries that are no longer eligible for IDA.

Pausing between successive ESAF arrangements to take stock of a country's achievements and its need for further reforms seems quite reasonable from the standpoint of the staff's task of evaluating programs and outcomes. I am less sure, however, what would be the impact of introducing such a pause on the momentum of a country's reform process, on domestic and external confidence in its adjustment, or on its external creditworthiness. It seems quite possible that these disadvantages might often outweigh the advantages of such a pause between arrangements.

Finally, I have not changed my view that extending ESAF maturities beyond 10 years is incompatible with the monetary character of the Fund. The present maturities impose no undue burden on most ESAF eligible countries, and it would be both counterproductive and unfair to establish a subclass of ESAF eligible countries that would receive longer maturities. In addition, we must consider the trade-off between extending maturities and continuing the ESAF itself. The latter is the only option I advocate that we continue examining.

As to the need for ESAF resources, past experience has shown that the staff consistently overestimates the need for ESAF resources. In the staff's defense, I would point out that such overestimation seems inherent to the situations that give rise to the need for ESAF resources, and that in all such cases overestimation is preferable, and easier to correct, than underestimation. Given this tendency toward overestimation, I am quite confident that it is a reasonable assumption that available ESAF resources will suffice until late 1998. Going beyond that period to estimate the demand for new commitments between 1999 and 2004 is considerably more tricky. Tricky or not, such a forecast does have limited value: it provides broad ranges, and keeps us mindful that concessional resources will continue to be needed throughout the medium term. At this point, however, the fact that sufficient resources will likely be available until 1998 does not require us to make a desperate and perhaps inappropriate rush to mobilize additional ESAF resources. At this stage, then, permit me to briefly reaffirm my present position.

The possibility of using GRA resources for the loan component of ESAF will depend on the liquidity position of the Fund, which in turn is related to the speed of the conclusion of the Eleventh Quota Review. Furthermore, in our view, this issue seems less difficult to resolve than the issue of what resources will be needed to make the facility concessional.

The members of my constituency are not much in favor of gold sales. One of them continues to strongly oppose the idea because of its possible impact on financial market assessments of the Fund's financial strength. Moreover, if gold were sold, only the income from the investment of the profits could be used for financing the subsidy requirement of an Interim ESAF. And finally, resuming gold sales after resisting for so long at a time when members are shrinking their aid budgets could open a Pandora's box of precedents. I noted that to cope with these concerns, the Managing Director has proposed having gold sales matched by bilateral contributions. Pursuing this idea, I wonder if the countries that most strongly oppose the sale of gold would not be more receptive to the idea if the countries who favor it most strongly would demonstrate their willingness to hold the sale of gold to a strict minimum by coming forward with bilateral contributions aimed at returning to a more equitable sharing of the burden of financing ESAF. More generally, I reaffirm my position that the use of the Fund's gold for ESAF must be approached with great caution and that any decision to do so should only be adopted by consensus.

As I have already stated, there is as yet no fully satisfactory solution for financing an Interim ESAF nor a self-sustained ESAF. A self-sustained ESAF might begin operating by 1999 if the annual commitments of SDR 800 million foreseen for a self-sustained ESAF launched in 2005 would be reduced to an annual amount of SDR 600 million. In both cases, these amounts will fall short of the resource needs of ESAF eligible countries. I therefore fail to see why this option of a self-sustained ESAF operational from 1999 should be discarded at this stage.

I understand that starting a self-sustained ESAF in 1999 would also require the consent of all ESAF trust lenders. Since this consent could only be forthcoming if creditors receive assurances that their claims on the ESAF trust are protected, it is proposed that additional protection could be given in the form of a gold pledge by the Fund. I note that the amount of gold to be pledged would be double the amount that would be sold under the 1999 option. I would nevertheless like to point out that the transfer of resources from the reserve account to the ESAF trust makes the latter financially stronger, as in the case of a company that increases its own resources and thus itself provides a certain protection for its original creditors. This would be especially true if the preferred status of the original trust fund creditors vis-à-vis any claim of the Fund on the trust would be confirmed.

Since a gold pledge is, of course, very similar in nature to a deferred sale of gold, the arguments against an outright sale of gold apply with equal strength to a gold pledge. The Articles of

Agreement, moreover, do not provide for the use of gold as a guarantee for the future repayment of funds.

Mr. Koissy made the following statement:

The continued availability of Fund resources under ESAF, over the medium term and beyond, is critically important for the ESAF eligible countries listed on table 1, page 10 of EBS/95/130. These countries are faced with difficult economic circumstances, including low per capita GNP, limited access to private capital markets, and very large foreign debt service obligations in comparison to their unstable export earnings.

At this stage of their development, ESAF eligible countries urgently need new resources on concessional terms in order to become successful in the rapidly changing world economic environment. It should be noted, however, that the implementation of structural policy measures in these countries, would have a greater impact on economic growth only if it were also accompanied by an effective foreign debt reduction scheme.

In any event, the point that needs to be made is that any provision of financing resources to these countries should aim at accelerating the pace of their economic growth, and enhancing their integration into global commodity and capital markets. The failure to contribute to rapid economic growth in ESAF eligible countries will increase the need for a longer period for structural adjustment. These arguments must be taken into account, when discussing the possibility to put in place, over the medium term, an "interim" and a "self-sustained" ESAF. The staff has prepared a set of papers which provide useful background information on the Fund's experience with the provision of financial resources to member countries, under ESAF since 1987. They also raised issues that need to be addressed carefully.

As regards access policy, in our view, the access to resources available under ESAF by eligible countries should depend mainly on the balance of payments needs of the member country, the strength of its adjustment efforts and its track record on the use of Fund resources. At the same time, the likelihood of obtaining financial assistance from other sources, in particular from bilateral donors must also be taken into account. In that context, the recent declining trend in aid flows from bilateral donors to low income countries is a sufficient ground to review the current access policy to ESAF resources.

We would strongly support the idea of granting higher access to countries that have shown their readiness to implement strong policies. It was encouraging to learn from the papers that the average access for three-year arrangements under ESAF increased from 110 percent of quota, for the 13 programs approved in the period since the enlargement and extension of the ESAF, to 123 percent of quota for first-time ESAF users during February 1994 - May 1995. At the same time, we note that for second-time users, the average access was 95 percent during that period. Our concern is with the relatively low average access for second-time users which may not be able to mobilize financial resources from other sources. We wonder whether a more flexible policy could be envisaged for repeat users of ESAF. For this group of countries, we believe that access limits must continue to take into account trends in bilateral and other multilateral aid flows and the degree of their external indebtedness. Consequently, we support a more differentiated access policy than in the past.

As regards the eligibility of member countries, we recognize that there was an initial need to make the list of countries eligible for the ESAF identical to countries eligible for IDA resources at the World Bank. In our view, there is no need to make these two lists identical. In determining the need to remove member countries from the list of users of Fund resources under ESAF, the main criteria should be a continued improvement of per capita GNP over a sufficiently long period and the member countries' capacity to service Fund credit from resources available in the GRA. In other words, the level of per capital GNP alone should not constitute a sufficient basis for the removal of a member country from the list of ESAF eligible countries. In that connection, it would be interesting to learn from the staff, the particular circumstances which, justify the fact that the Dominican Republic, the Philippines, and St. Kitts and Nevis are still eligible for the use of Fund resources under ESAF, while they are no longer IDA-eligible countries at the World Bank?

The staff papers have raised the question of whether or not there could be a "blend" of GRA and ESAF resources through parallel arrangements. We are of the view that this blending could be an option for countries that have clearly shown the capacity to service their nonconcessional debt. However, it should not lead to a reduction of access limit to, nor should it reduce the concessionality of ESAF resources. Parallel access to GRA should be envisaged only if the financing needs of an eligible member country cannot meaningfully be covered by ESAF resources alone.

Concerning the potential demand for resources available under both the current and the "interim" ESAF, it is difficult to make any judgment on the assumptions underlying staff projections. We note that these projections take into account the average access recorded during the 15-month period that ended in May of this year for the first-time users. However, we have no basis to make a judgment on other assumptions. We wonder how ESAF operations would be affected if the actual financing needs of users happen to be substantially larger than the level currently projected by the staff?

The funding of an "interim" ESAF is an issue that deserves special attention. The staff is now anticipating that such an "interim" ESAF is likely to cover the six-year period that will begin in 1999, after the current ESAF resources have been fully committed and before an SDA-financed ESAF could become effective. We do believe that the three countries that are arrears cases should also be taken into account while projecting the level of resources that will be needed to finance the "interim" ESAF. Regardless of the funding needs for the "interim" ESAF, it is our view that for the loan component, serious consideration must be given to the combination of bilateral loans and the use of GRA resources.

The subsidy component could be covered by proceeds from the sales of a "modest" quantity of the Fund's gold holdings. The precise quantity of gold to be sold will have to be determined carefully. At the same time, we support the staff's suggestion that at least, one-half of the subsidy requirements should be covered by resources obtained from bilateral contributions, including from refunds under SCA-2. The other half should be financed from other sources, including the use of the "profits" resulting from the sales of Fund's gold holdings mentioned above.

Concerning the issue of SDA-financed "self-sustained" ESAF, although we would prefer to see a self-sustained ESAF operational as early as possible, we however, support the staff's view that, given the relatively small size of an early "self-sustained" ESAF, it would be preferable to rely on an "interim" ESAF for some time.

Finally, on the extension of ESAF maturities, we do not agree with the staff that such an extension will violate the basic principle of "uniformity of treatment of member countries" by the Fund. It can be argued that by proposing a "differentiated" access policy for member countries on the basis of their performance, we have already implicitly abandoned the principle of "uniformity of treatment" of member countries.

To conclude, we strongly believe that there is a need to provide substantial and continued financial support to low income countries which remain heavily indebted and have only limited access to other financing sources apart from multilateral concessional loans. Given that situation, bilateral donors should increase their contributions to ESAF resources while addressing the debt problem presently facing the vast majority of ESAF-eligible countries.

Mr. Bergo made the following statement:

At the outset, I would like to welcome today's discussion and the staff papers, addressing both the modalities of a possible future ESAF and its financing, including the alternative of using part of the Fund's gold for this purpose. The question of the modalities of ESAF can most fruitfully be discussed in the context of some knowledge of its financing, and, vice versa, discussion of possible sales of the Fund's gold is interesting only if the purpose of the sales are clear.

There are, however, some loose ends that should be tied up before we lay down with any great precision the modalities of possible ESAF-like facilities in the longer term. I see a need, for example, for a thorough debate on the more precise role of the Fund in poor member countries, as opposed to that of other IFIs and bilateral donors, before concluding the discussion. We have, as far as I can see, financial resources for a continuation of present policies until end 1998. Even if there is uncertainty related to this estimate, and acknowledging that one would have to seek the consent of lenders for such a continuation, I am confident that we have time to allow an "interactive process" whereby the role of the Fund in poor countries, the financing of the facility and the modalities of the facility can be fitted together in an optimal way.

That being said, I am in full agreement with the staff that many poor countries will need ESAF-like assistance from the Fund for many years to come. Seen both from the Fund's side and from the side of the individual user of ESAF, the facility has so far proved useful and served its intention well. I am thus in favor of a continuation of ESAF and that we start planning for it now. I am, however, not convinced that a permanent ESAF represents the best use of the revolving resources from the proceeds of the sale of some of the Fund's gold in the 1970s. In a way that would be admitting defeat in the efforts to bring growth and relative prosperity to today's poor countries. Unlike short-term balance of payments problems, which can hit rich and poor countries alike, and must be regarded as a reoccurring phenomenon in our economic system, the operations of the ESAF are aimed at through fostering adjustment and growth taking countries off the eligibility list, hopefully never to return to it. Recent developments have, in fact, been rather positive, and throwing in the towel some ten years in advance seems to me overly defeatist. Thus, I see no compelling need for taking early decisions on a permanent ESAF.

Apart from the question on financing of the subsidy account, I am in broad agreement with the staff. This includes the question on the need to differentiate access to the facility, the inadvisability in extending the maturities and to consider the eligibility list with a view to shortening it. Linking it to IDA eligibility would seem appropriate. The loan resources for an extended ESAF should be financed from new loans from bilateral sources as before. However, there might be cases where it might be appropriate to consider ESAF arrangements to be supplemented by GRA resources on normal extended arrangement terms through parallel arrangements for countries that have a capacity to service some non-concessional debt. As Mr. Mirakhor points out, this could facilitate the graduation of some low-income countries to traditional Fund facilities. This raises, however, some difficult questions with regard to eligibility which calls for great caution. Such "blending" of resources through parallel arrangements should, in any case, take place only under strict guidelines, and, for the sake of uniform treatment, not blur the division between concessional lending and general Fund resources.

With regard to the question on how to provide protection to lenders to the loan account under a continued ESAF, I am skeptical to changing the present system of providing protection through the ESAF Reserve Account. I fear that a renegotiation of borrowing agreements for the present ESAF will prove time-consuming and burdensome, and I would assume that it also would have negative effects on the possibility of securing new bilateral loans for a continued ESAF after 1998. Furthermore, as I am not yet convinced that we should aim at a permanent, self-sustained ESAF, I would argue that we should be careful not to impede on the workings of the present system in preparation for such a distant possibility.

Given the prognosis for disbursement of development aid in the years to come, the financing of the subsidy element represents the greatest challenge.

The staff has explored various methods for financing of the subsidy element during the "interim" ESAF, which I would have preferred to name ESAF III, not implicitly indicating that there should be more of the same thing at the other end, including sales of gold.

Regarding possible sales of gold for ESAF purposes, the situation in my constituency is complex. Most countries in my constituency have reservations--although to various degrees--to financing part of the subsidy element of an extended ESAF by selling gold, even if only the proceeds from investment of the gold sales are used. They can, however, accept to study the various financing options further. One country supports limited gold sales, which another maintains the view that no gold should be sold.

Should the Board in the end decide that it would be appropriate to finance the subsidy element partly through the sale of gold, it is of the utmost importance that the amount to be sold is not determined as a residual, to meet some predetermined target for the size of the subsidy account. Rather it should be set as a given agreed share of the total subsidy amount in a burden-sharing approach. Such a burden-sharing could have a positive catalytic effect and act as a stimulus to budgeting contributions. In the illustrative numerical calculations in the staff paper, it is assumed that 50 percent of the necessary amount would come from gold sales. This is an unnecessary pessimistic assumption, and our ambitions with regard to bringing forward bilateral contributions should certainly be higher than that. Should this strategy nevertheless fail to produce the necessary amounts in the subsidy account, either the interest rate would have to be stipulated in accordance with the amounts available, or less than the full amount of capital be lent at traditional ESAF interest rates.

Mr. Evans made the following statement:

Glad of this opportunity to discuss these important issues: hope we can make progress on the basis of these useful papers.

The United Kingdom continues to believe in making ESAF permanent, in providing some ESAF recipients with more concessional terms, and using the resources of the Fund--and not replying on bilateral contributions--to finance the moderate costs involved.

We need to address the problems faced by a number of poor countries which are heavily indebted to the multilaterals and which are following sound policies. The U.K., objective is to ensure that these countries receive substantial reliefs, including greater certainty about future debt relief. I continue to think that the number of potential beneficiaries are greater than the Fund staff admit, but even so the number is not large, and the resources required are not huge. So this problem is a manageable one: it comes down to a question of will.

The multilateral indebtedness problem is certainly not confined to debts owed to the Fund: the World Bank and the African Development Bank are also important elements in the overall picture. At the World Bank, the management has put forward constructive ideas. These include, in particular, special IDA allocations to the poorest, most indebted countries, and differentiated IDA terms. We know this subject is a priority for the new President. In this context, there is a clear need for the Fund to make its own important contribution.

The staff has put forward a sophisticated system for forecasting the take-up of ESAF over the next decade or so. I would like to complement that by looking at the issue more simply: in terms of the annual amounts being committed. As I understand it, the figures for annual commitments to ESAF and the structural adjustment facility (SAF), in SDR billions are as follows: for the period from 1988 to 1994, about SDR 1 billion a year, for the period 1995 to 1998, about SDR 1.5 billion a year, and for the period 1999 to 2000, about 1.6 billion a year, including the arrears cases. Once again, as report notes, commitments have fallen well short of expectations, and the successor ESAF facility looks as though it will last until at least 1998. The annual figures I have quoted show that this allows for a substantially higher take-up over the next three years than in the past. These figures are, clearly, extremely uncertain and there is a wide margin on either side. But I think that these figures can be used as a basis for our decisions and future directions even though the bias is still likely to be in the same direction.

Concerning an interim versus a self-sustained ESAF, I start off from the proposition that bilateral contributions to a continuing ESAF are simply unrealistic. They are not a basis for giving us the assurances we need. We want to give a simple and clear message to the likely recipients that provided that sound policies are pursued there will not be an abrupt withdrawal of Fund help in a few years time. I would much prefer to go straight to a self-sustaining ESAF from 1999. To contemplate an interim ESAF, with bilateral contributions or from SCA-2, would not give us, and more important the potential recipients, the confidence that is undoubtedly needed.

I accept that, on present forecasts, the level of resources likely to be available for a self-sustaining ESAF from 1999 may well not be enough to meet the likely demands, uncertain though those are. I believe we should commit ourselves now to filling this gap. How precisely we do it, we do not need to decide now, but I believe the following are strong candidates: the sale and reinvestment of gold; an acceptance by creditors that a lower coverage by the reserve account would be both possible and prudent; use of gold pledges to release resources from the ESAF reserve account; and use of GRA resources as loanable funds for ESAF.

My Governor has proposed the idea of extending ESAF maturities as a way of giving countries assurances of sustained Fund help and of providing an exit strategy for most. I have noted the conservative comments of Fund staff. I wonder why they do not see the possibility of establishing objective criteria for countries with a heavy multilateral debt burden. On the issue of resources, I agree with the staff: extended maturities will indeed need some limited extra finance. The paper goes on to say that in some cases extended maturities would not be enough to give countries the help they need without further recourse to Fund resources. The staff may well be right that in a few cases our proposals do not go far enough to solve all the problems. But this is, of course, a reason for more, not less, radical options.

If there is insufficient support for the Chancellor's proposal, then I would suggest instead that for those countries agreeing an ESAF arrangement, Fund staff should be able to give a clear indication that where there is a good track record, a strong adjustment effort and continuing need, a successor ESAF arrangement would be available in future. The staff cannot, however, begin to give such assurances until there is a decision to continue ESAF operations after the present ESAF trust expires. This is one reason why we believe it is important to make an early decision in principle to move to a self-sustaining ESAF from 1999, and to commit ourselves to finding the resources from within the Fund necessary to do that.

Let me take up a few other issues in the paper:

On access policy, we continue to think that the increase in access agreed last year in the context of the GRA, should be reflected, at least to a limited extent and within available resources, in ESAF access policy. What I think this means is a willingness to use higher access for those countries which would make good use of them, especially in the context of their multilateral and overall debt position.

On graduation, I support moving better-off countries within this group away from further use of ESAF resources. On the same arguments, there is more scope for using blends of ESAF and GRA resources.

The suggestion that between successive ESAF programs there should be a period of stocktaking looks a sensible one. It would be better if this could take place in the last year of an ESAF rather than having an uncertain and awkward interim period without such a program.

Where do we go from here? I hope we can make commitments now: a self-sustaining ESAF after the successor ESAF facility runs out; the promise of continuing help for the most indebted, by a commitment to find the necessary resources from within the Fund.

We also need to look to the staff for further work in the following areas: alternative scenarios for the amount of ESAF use up to and beyond 1998; alternative assumptions about coverage needed for the ESAF reserve account, and the support that could be given by gold pledges; gold sales to supplement ESAF resources; use of GRA resources for ESAF loans.

Mr. Autheman made the following statement:

I support the goal of a permanent self-sustained ESAF, using accumulated reserves to finance this facility of the Fund as soon as feasible. The purpose is to guarantee to all Fund members that they will be able to have access to Fund resources in case of need. It is not to create a facility to which some members would be permanently addicted.

Following up on the staff assessment, I understand and agree that it is not possible at the present stage to consider moving directly from the ESAF Trust to a self-sustained ESAF. This could only finance annual commitments of 600 million SDRs, which obviously would fall short of any assessment of need and would be lower than the annual amount committed in the past. The need for an interim ESAF is somewhat overstated in the staff paper, but I do not think that we could reduce it to the point where there would no longer be a need for an interim arrangement.

The basic assumption is that the ESAF Trust Reserve Account will need to be used in order to finance the permanent ESAF. This has two important consequences. First, we must secure these reserves better than we have done until now. Second, since we fall short of what is needed to finance a permanent ESAF, we must strengthen them. I will elaborate on each of the two issues, trying to offer a few avenues for reflection.

If we want to finance a self-sustained ESAF at the beginning of the next century, we will need to rely on 100 percent of the accumulated unused reserve. The question is not whether creditors could agree to reduce to 75 percent, 50 percent, 36 percent, or any lower figure, the maximum level of reserves: lowering the coverage of reserves does not increase the amount of reserves and therefore the capacity to finance a self-sustained ESAF. The issue is that any arrear between now and 2004 would reduce the amount of resources available for a permanent ESAF. Therefore, I assume that our implicit target has to be zero default between now and 2004.

How can we reduce the risk borne by the ESAF reserve account? First, by not increasing it unduly. We need to revisit the use of the ESAF Trust in the settlement of our arrears strategy. I do not think that the Sierra Leone model can be used again--for instance, in Zambia or in other countries. The consequence would be to transfer a risk, which is considered as very high by the membership, from the GRA, where it would be covered by the available resources of the SCA-2, to the ESAF Trust, where it would have to be borne by the reserve account, which we need to protect. If the amounts at stake were limited, we could run that risk; but the magnitude of the risk is such that this approach would become inconsistent with our purpose. If my approximate calculation is right, financing our outstanding claims on Zambia by the ESAF trust would imply that Zambia would represent something like 50 percent of the present accumulated reserves of the ESAF Trust account. I am not in a position today to offer a solution, but I think we must look at this issue urgently.

Another suggestion would be to transfer, from now on, the risk of the ESAF Trust to the well provisioned GRA. Could ESAF loans be made to the GRA, say, from January 1, 1996? The risk would be borne by the GRA, and therefore by our general reserves, and subsidies would of course continue to be provided by participants to the ESAF Trust Subsidy Account. The maximum risk covered by the ESAF Account would be divided by half. It would culminate in SDR 4 billion at the end of this year. It would begin to decline as early as 1996, instead of increasing up to SDR 8 billion in 2000.

All of these approaches, which would make us more confident that we could achieve the targeted level of accumulated reserves would not solve the main problem, which is our limited capacity to finance a self-subsidized ESAF. For that, we need to supplement the reserve account of the ESAF trust with other resources.

I will not elaborate once more on the reasons why my country remains opposed to gold sales. We do not think that the gold of the Fund is an appropriate substitute for the reluctance of too many members to continue their support of ESAF. We would also caution against declaring too loudly that we should consider a never-more option; that support to ESAF is no longer worth a penny or a cent. It could be counterproductive and would jeopardize, as Mr. Mesaki said at a previous meeting, the smooth disbursement of committed subsidies.

I think that it is still possible to increase the subsidies account. Let me give four examples. In the short term, there is no prospect for a contribution by the United States higher than $25 million. I do not believe that in the long run we should *consider this the final contribution of the most prominent member* of this institution. It may be true in 1995 and 1996; but, as we know, political climates change. I could very well foresee a situation where, with Palestine becoming an independent state, and peace breaking its final success in the Middle East, the U.S. Administration would find strong grounds for reconsidering its support to the ESAF Trust Subsidy Account.

Second, we should join our efforts to try to convince another prominent member of this institution, Germany, to reconsider its present position. The case has not been put well enough to the German Parliament that ESAF is not an Africa-only facility;

ESAF is also a transition-country facility. Since the support for transition countries in Germany is so strong, we could make better use of this argument.

My third example is that we should invite Brunei, which is joining this institution rather late but in a very wealthy position, to come with a gift.

Finally, I invite some of my colleagues to reflect on the very positive impact which an announcement by Hong Kong, some time in the future, that it intends to contribute to the subsidy account of ESAF would have on the standing of the 1997 Annual Meetings. I maintain that the Managing Director's objective should be to overshoot the subsidy account target. I am open to other options which colleagues could envisage, but I am not optimistic that these would meet all of our needs.

I think we should have a look at another option, which is to transfer reserves accumulated in the SCA-2 to the ESAF reserve account. This gives rise immediately to the objection that this is difficult because it requires consent by all contributors. I find this objection strange if it is raised by members who propose even more difficult options, such as some which my country would find very difficult to support. It is reasonable to expect that the SCA-2 will end up being overfunded. A reimbursement to members would obviously run contrary to the interests of the Fund. A short calculation shows that a 1 billion transfer in 2000 would make it possible to begin a 800 million per year self-sustained ESAF by January 2001.

I would point out that the individual case for such a transfer is very strong. A permanent ESAF would be self-sustained, which means self-subsidized and self-guaranteed. It means that on a permanent basis the GRA would no longer be at risk for all countries eligible for ESAF, which have been the countries where the risk of protected areas is higher. A risk which has been borne by the GRA in the past would be permanently transferred to ESAF. It is, therefore, logical to transfer special reserves which were agreed upon in order to cover such risks.

I am finally ready to discuss any gold pledge under the same assumption as in 1990. A gold pledge is a final touch to an agreement which is already strong and secure. It should not be a way to try to agree in advance to gold sales which would be inescapable.

Since I have been very long, I will not comment on other topics. I will only point out that I am in agreement with Messrs. Kiekens, Mirakhor and Evans on the issue of access policy.

Access policy under ESAF must be consistent with access policy of the Fund itself. Therefore, I do not like very much the concept of repeat users. We have no rule in the Fund that repeat users deserve lower access. We have a very sound rule that the level of access must be proportionate to the strength of the program.

Mr. Clark made the following statement:

I would like to commend the comprehensive yet concise set of papers.

I also found a lot to agree with in Mr. Evans and I am intrigued by Mr. Autheman's proposals, some of which I would like to think further about before commenting.

To review the key points on how to use gold reserves in the context of an interim or permanent ESAF, I would tend to agree with the general conclusions of staff. That is, pledging to sell gold in order to finance subsidies or to facilitate an early initiation of a self-sustaining ESAF would reduce substantially the resources a valuable, probably below the level to make a permanent ESAF viable. The declining availability of bilateral aid resources, which is a big problem now, is not likely to have improved at the time of the self-sustaining ESAF. I differ slightly with Mr. Evans and agree with Mr. Autheman in that I think it would be preferable to delay the transfer of ESAF trust reserves for permanent financing until they are sufficient to meet the needs of a self-financed facility.

This probably means that an interim ESAF is necessary, although, like Mr. Autheman, I would like to see the duration of this interim facility as short as possible. I fully support the sale of a modest amount of the Fund's holding of gold reserves and use of the investment income on the profits from these sales to finance the subsidy component of an interim ESAF. My authorities would prefer that all of the subsidy requirement for the interim ESAF by generated by gold sales, not simply one half or two thirds. Our position on gold sales is well known and is related mostly to portfolio considerations and maximizing existing resources; I will not go into these again.

I am aware that not all chairs share the views of Mr. Evans and me on the sale of gold. I suspect that, in the end, a compromise will have to be struck. I would prefer to reserve my comments on a possible alternative for that time. I could support some early use of Reserve Account resources, to the extent that a reduction in the size or length of an interim ESAF would increase the size of the self-sustaining ESAF.

Let me now deal with the issues raised in the ESAF paper.

With regard to greater differentiation of access, the suggestions made by staff to make access levels more responsive to the borrowers' degree of adjustment effort and outstanding use of Fund credit make eminent good sense, particularly given the external financing climate. I actually had hoped this was standard practice already. Nevertheless, it is worth reinforcing these principles since the trends in aid flows--declining real amounts and greater selectivity--as noted at the Board discussion earlier this year on aid flows, are clear and not likely to change in the medium term. Consequently, greater discretion on loan amounts should definitely be exercised; of course existing limits should be preserved.

As to demand for ESAF resources, the staff notes in the introduction that repeat users of ESAF will need to focus on more complex reforms to strengthen growth and external viability. I have two questions for the staff in this regard. Are we confident that this type of more "complex reform" will not necessitate a higher amount of ESAF support? Second, how will we make sure that these "more complex" type of reforms will not infringe unduly on the work of the World Bank?

Time for "stocktaking" between ESAF-supported programs is definitely advisable given the type of structural change which can take place in an economy throughout an ESAF, and the possible program re-orientation needed as a result.

While in principle I support the concept of applying a more systematic approach to eligibility, bringing ESAF eligibility into line with IDA may not be warranted in all cases. In particular, my St. Kitts Authorities have valid concerns based on their special circumstances. The criteria laid out on page 11 on per capita income and capacity to pay are sensible, and at first glance, St. Kitts would appear to meet these criteria. At the same time, the vulnerability and risks faced by these micro-island economies are not captured in these measures. These economies remain immensely vulnerable, particularly to natural disasters, which can wipe out the means of production and financial stability for long periods of time. Volcanic activity now being experienced in Montserrat and the recent spate of hurricanes--the latest having hit St. Kitts yesterday--have made this area all intensely aware of the vulnerability. Staff have suggested we undertake a brief study on the situation in each country; I fully endorse this initiative in order to get a better understanding of the special circumstances facing these members. I also liked Mr. Berrizbeitia's suggestion that the Fund establish its own criteria for ESAF-eligibility.

As an aside, I welcome the coverage in the text on the option to blend concessional and non-concessional Fund resources. There are several countries currently receiving blend financing at the World Bank whose economic indicators fall somewhere inside the criteria described above. Could I ask if staff have any plans to set guidelines on which countries would be suitable for IMF blend financing.

As regards current ESAF resources (1995-1998), the working assumptions appear for the most part to be reasonable. If anything, I would say that staff have over-estimated demand for both the 1995--1998 and 1999--2004 periods, particularly since past country-by-country projections have generally overestimated the pace of new commitments. Also, I am not convinced that the decision to make access more flexible will result in a considerably larger net outlay of ESAF resources (despite staff's projections). In this sense, a range is probably a more realistic way of estimating requirements.

On financing the loan component of an interim ESAF, we are open to either option, i.e., bilateral loans through the existing ESAF structure, or the use of GRA resources; however, since providing protection to creditors through the Reserve Account would result in a substantial delay of a self-sustained ESAF, we would prefer using GRA resources. On this issue, I welcome Mr. Berrizbeitia's question regarding the implications on the Fund's liquidity position from using GRA resources to finance the loan component of ESAF.

I referred to the use of the Reserve Account before full coverage of ESAF in my response to the question about pledging gold. To reiterate, I agree that the idea to use the Reserve Account before outstanding obligations are fully covered should not be pursued further. If the permanent ESAF is to be truly self-sustaining, we must ensure that resources available are sufficient to meet the needs thereby avoiding recourse to further requests for bilateral contributions. I think we all agree that the prospects of future external financing are unfavorable.

On financing the subsidy component of an interim ESAF, I am not in total agreement with staff's proposal that at least one half of the requirements for the subsidy component should come from bilateral sources, including refunds from SCA-2. First of all, as I noted in my comments on gold, I would prefer that all efforts be taken to make optimal use of existing resources since the availability of aid financing in the near and medium-term is not promising. Consequently, I would prefer that the entire amount of the subsidy be financed by mobilization of existing resources, i.e., the currently noninterest bearing asset. Second, the proposal put to the Board in April recommended that only one third of the subsidy by sourced bilaterally--why has it risen to one-half? As regards the use of SCA-2 refunds, we are opposed on the grounds raised by several chairs earlier this year that this would undermine the original principles upon which SCA-2 was founded. In addition, some chairs stated this would require parliamentary or congressional approval, something we would want to avoid.

Concerning extension of ESAF maturities, along the lines of what was said by this chair earlier this year about the group of 16 countries with heavy multilateral debt burdens, I continue to believe that these countries have a debt overhang to multilateral institutions which, to use the words from the Managing Director's concluding remarks "would clearly impede their development prospects". While this is a problem which involves other multilaterals--possibly more so than the Fund--I believe that we are still dismissing the problem to quickly.

In addition, the staff assessment on pages 23 and 24 is almost exclusively driven by the availability of resources, and how addressing this problem would take resources away from the interim and self-sustaining ESAFs. I would note that staff did not use that approach when assessing the viability of setting up an interim ESAF; that is, they did not look at the availability of resources to determine whether we should set up an interim ESAF. Using the same logic--a decision on dealing with the problem of debt overhang should be based on economic and financial analysis, not simply whether there are enough resources to go around. The fact is that finding any aid resources is already a big problem, whether it be for an interim or permanent ESAF, or debt relief--the question is how best to use whatever resources donors are willing to donate.

If donors decide that a self-sustaining ESAF is a greater priority than addressing the debt problem of approximately 20 countries, then so be it. Nevertheless, this institution cannot ignore the plight faced by a small but significant group of its members. To this group, an ESAF facility is no solution if it does not provide any hope of pulling them out of the debt trap. For this we will need even more imaginative and coordinated thinking on the parts of all member governments and multilateral institutions.

The Chairman remarked that the problem of debt of developing countries to multilateral institutions was indeed serious. It was difficult to envisage the extent of indebtedness of those countries in the future and to tailor Fund support on that basis. As a monetary institution, the Fund could not provide grants or forgive debt; however, by helping those countries achieve a sustainable rate of growth consistent with their growth potential, the Fund would be contributing significantly to alleviating their debt problem. It was for that reason that the staff was proposing a continuation of ESAF-type operations.

Mr. Clark considered that a continuation of the ESAF would mean that heavily indebted countries would be seeking ESAF-supported programs permanently, which would not solve their problem of indebtedness to multilateral institutions. In view of those considerations, he had asked the staff to seek an imaginative solution to the problem.

Mr. Kaeser made the following statement:

At the outset I have to recall that my Swiss authorities are firmly supporting ESAF and that they were successful in convincing the Parliament and the public opinion that this facility was not another instrument of development assistance, which should belong to the World Bank but that the Fund badly needed this facility in order to support the structural adjustment of the poorest countries at terms and conditions which are affordable to them. They managed to convince the opponents and the skeptics by stressing mainly two arguments: first the temporary character of ESAF and, second, the need to support adjustment in the poorest countries. This is to say that they do not warmly welcome the paper prepared by the staff. According to this paper, ESAF should become a permanent feature, the countries presently eligible to ESAF should retain their eligibility well into the 21st century and ESAF should partly make good for the shortfall of ODA. The differences between IDA and ESAF become more and more blurred, save the different maturities of the loans.

We think that the transformation of ESAF into a permanent facility is a fundamental change in the character of this facility and that it should be only decided if and when the conditions are met, and in the light of the circumstances prevailing at this time. Therefore, we do not like the term "interim" ESAF. On the other hand, we were prepared to support the creation of an ESAF III, whose loan and subsidy account would be financed as in the past by bilateral contributions from industrial and emerging countries in strong balance of payments positions. What was possible in the past should also be possible in the future, and Mr. Autheman gave us reason not to despair.

In any case, a continuation of ESAF would require a streamlining of the eligibility criteria in order to preserve the character of ESAF as a pure adjustment supporting facility. The IDA eligibility should remain the precondition for becoming ESAF eligible. We should give to the ESAF-eligible countries the chance to perform a comprehensive adjustment program with the support of this facility, but after a reasonable period of time--let's say after three ESAF-supported programs--they should be withdrawn from the list. In other words, the role of the Fund should be to give to the eligible countries one fair chance to adjust and to encourage them to seize it. Going further would be to provide development assistance, which is not a task of the Fund. Furthermore, countries with access to the financial markets should also be removed from the list. Such streamlining of the list of eligible countries would probably reduce the potential demand for ESAF resources.

Concerning a lengthening of ESAF maturities on new ESAF loans, we agree that the additional financing required for the subsidy account may be problematic. We also agree that, for monitoring purposes, a succession of ESAF arrangements seems preferable to the extension of maturities.

We agree that it would be useful to take stock of the achievements of an ESAF arrangement and of the needs for further reforms, as this should improve the design of programs and help understand the reasons of their success or failure. In our view, this exercise should take place during the last year of an ESAF arrangement, since we do not see how it could be implemented between two arrangements. If such an analysis were to be undertaken between two arrangements, would a country continue to receive financial assistance from the Fund? Who should perform this evaluation? The input by an independent evaluation unit could prove to be very useful in complementing the staff analysis.

As we pointed out in the discussion on multilateral debt, we are in favor of a more differentiated access policy, both in regard to the performance of a country and to its overall service capacity. Higher access should be provided to strong performers within the existing limits, weak performers should have lower access. This implies that staff reports supporting requests for an ESAF arrangement should be more explicit than in the past on the consideration underlying recommendations on access in individual cases.

We do not consider blending ESAF resources with GRA resources as an option. ESAF-eligible countries should be given the full benefit of the ESAF concessionality, but, as we said, we should streamline the eligibility criteria.

Regarding the subject of gold, we expressed our opposition to the idea of a gold sale when we discussed this issue at the beginning of June. We still hold to this view and our opposition also covers the pledging of gold.

Undervalued gold holdings represent hidden reserves that contribute to the financial soundness of the institution. By strengthening the creditworthiness of the Fund, gold holdings also enhance the institution's ability to borrow. The sale, or the pledging of Fund gold would be interpreted as an erosion of its reserves and as a weakening of its financial position. This would be particularly unfortunate at a time in which the portfolio of the Fund is not optimally balanced and it might have to respond to new systemic crises.

Furthermore, to quote Mr. Kiekens, "resuming gold sales, after resisting for so long at a time when members are shrinking their aid budgets, could open a Pandora's box of precedents."

Having decided once in favor of gold sales for a specific purpose, such as the one mentioned in the context of financing ESAF operations for an interim period, appetite could easily be whetted for using this source for other purposes. Freeing this source of untapped financial resources could therefore lead very quickly to a substantial reduction of the Fund's gold holdings and to an erosion of its reserves.

Needless to say, such a development could become a major embarrassment for central banks with important gold assets.

Ms. Lissakers made the following statement:

It is very clear that there is a broad consensus that ESAF has helped to promote and advance the Fund's main mission of economic stabilization and structural reform by making financing available on concessional terms. I must say I agree with Mr. Autheman's point that while one certainly would hope that our policy advice and the efforts undertaken by members will mean that reliance on Fund resources in general will be very occasional and short term, the reality at the moment, at least, is that we have a very large number of poor member countries whose economic prospects would clearly be damaged if they had to undertake adjustment programs supported by nonconcessional financing. At least for an extended period, we have to look at the need to continue to have available an ESAF facility for these members. Whether or not it is permanent, I think, is an issue that we really do not have to settle. There is clearly a need for a large number of member countries to have access to this kind of financing in order for them to participate fully as members of the institution, and to benefit fully from Fund-supported adjustment programs.

There are clearly divisions about the means of financing the continuation of ESAF. The range of options involve a lot of difficult choices and trade-offs, and I guess we have not really found an acceptable formula. Very clearly, a workable option would have to reflect at least the current realities of very tight bilateral aid budgets. I hope Mr. Autheman is right about the changing political climate and attitudes toward foreign assistance, but at the moment we have a very difficult climate, not just in this country, but in many other member countries, as well. So I think it is a constraint we have to build into our planning. That is unfortunately the reality. We also have sharply divergent views on the question of mobilizing the Fund's gold resources and I will come back to that. Any solution would certainly have to continue to provide assurances to ESAF and to general resources account creditors and it should generate resources sufficient to meet anticipated demands.

We agree with the staff that the first-best solution would result in an interim financing scheme after 1998 that would permit full funding of projected ESAF needs, although we recognize that there is a high degree of uncertainty about the precise level of those needs. The use of bilateral contributions to finance the subsidy elements is subject to uncertainty, as I said. In these circumstances, we believe that fully funding an interim ESAF will require maximizing use of full Fund resources, and in our view, at least, relying on the investment income from the profits of a modest sale of Fund gold to meet subsidy requirements during the interim period would constitute an appropriate use of this under utilized asset. In fact, this was recognized by the decision to mobilize gold in the 1970s. And I am sure the same arguments about opening Pandora's box were made then that are being made now. I do not see that there is any reason to think those fears would be realized now any more than they were then. It turned out to be a very sensible and sound use of this asset, which is currently not effectively mobilized in our view. The gold profits and the income accumulated from the investment of the 1970s sales proceeds are the key funding source for a self-sustained ESAF that we are talking about.

Augmenting these monies with an additional mobilization of gold to account for new funding needs would, in effect, just update an earlier decision that reflects new financing needs among a larger pool of eligible countries. Moreover, unlike previous gold sales, the proposed disposition of gold profits currently under most active consideration would preserve the principal amount for continued Fund creditor protection.

The proposal to bring forward ESAF self-sustainability by using a portion of the ESAF reserves in lieu of gold sales seems to us an unsatisfactory second-best solution as it would significantly reduce the amount of resources available for a self-sustaining severe, and would result in a level of lending that is substantially below the projected demand. Indeed, the projected commitment of SDR 600 million annually with use of the reserve would be lower in nominal terms than past ESAFs and some 25 percent less than would be possible for self sustainability beginning in 2005. Using a portion of the reserve to finance the interim ESAF while giving ESAF creditors continued full protection by means of a gold pledge would not solve this problem, because we would still have a shortfall in available financing in addition to other questions about a gold pledge, including the diversion of that security from the general resources account.

There may be alternative means, however, of providing ESAF creditors with full risk protection without recourse to a gold pledge. The Fund could, as Mr. Autheman mentioned, decide to extend to ESAF creditors the full backing of Fund resources, i.e., the protection currently enjoyed by regular general resources account creditors. The modalities of such an operation require further clarification, obviously, but it would essentially involve shifting existing creditor and debtor arrangements with the ESAF trust to arrangements with the general resources account. The general resources account would assume some or all of the existing ESAF trust assets, its loans to borrowers and its liabilities to creditors. And future lending would be funnelled through the general resources account. The subsidy commitments would then continue to finance concessional lending terms on these arrangements.

The main advantages of this proposal over the gold pledge are that it would achieve some of the same financial objectives, i.e., freeing up the existing ESAF reserves, while providing full protection to ESAF creditors. And did could be implemented by Fund decision without requiring legislative approval for gold mobilization.

This approach would require reopening existing loan agreements, and there would be other administrative complications that we would have to look at carefully. But, since creditors would in fact receive better protection than they currently have, or will have any time soon, that might perhaps allay some of the difficulties in reopening the loan agreements. We would certainly be interested in both the staff and other members' reactions to this option. I think it is at least--I am not necessarily endorsing this option--an option worth taking a closer look at.

With regard to the questions of access limits and eligibility, we would certainly support some flexibility on access. We think we could support a differentiated approach that is suggested in the report, which would help to stretch current ESAF resources beyond 1998. I also agree with Mr. Kiekens's suggestion that the staff reports on programs should perhaps be a little more explicit on the selection of the actual access being recommended. Sometimes we are quite uncertain about how a given number was decided on.

The possibilities for blending ESAF and general resources account resources also deserve greater attention, as do the issues surrounding ESAF-eligibility and prospects for graduation. We do think there should be a graduation policy for ESAF, although we have an open mind on the question of using IDA-eligibility as the criterion, or developing our own criterion, even though the latter could involve some redundancy. But we have an open mind on that.

One option might be to have a tiered scale of concessionality, that could be applied to those countries not requiring full ESAF terms, or those that are close to graduating, but, again, I do not know how difficult this would be given the principle of uniformity of treatment. The staff raise some concerns on that. Perhaps the staff could comment on this possibility a little bit as we go on.

Finally, as Mr. Evans said, we really cannot discuss the future of ESAF without addressing the question of the unsustainable multilateral debt burden of a few ESAF users. This is, as Mr. Clark said, really an issue for the international financial institutions community to address, as a group, but with due regard to the features of the individual institutions, including the monetary character of the Fund. It is a problem that we need to address, and address effectively. And I cannot see, nor can my authorities see, how a solution to this problem can be found without the participation of the Fund in a manner that is consistent with its own operating principles. And ESAF would seem to be the most logical instrument for addressing the problem. It involves a limited number of countries, but it is a big problem for that small group of countries, as we have said before. In our view, some form of debt relief could be accomplished through grants or more modestly by extending ESAF maturities. Certainly, the use of a small amount of Fund gold for this purpose would avoid dipping into already scarce existing ESAF resources. But sooner or later we are going to have to come to grips with this problem in the context of a community-wide effort. And I think we have to incorporate that into our ESAF planning over the long term.

Just to summarize briefly, we recognize the desire for progress on the range of issues affecting the role of ESAF, as well as its future financing needs. We need to say something to the Interim Committee. We do not see, however, that the October date poses an operational constraint given that ESAF funding is sufficient through at least 1998 and possibly longer, so we do not need to rush to judgment now on the outcome of the questions affecting gold sales, the commencement of self-sustainability, debt reduction and the other issues. Positions on a number of these issues are likely to evolve as full financing needs become more apparent and as we continue to explore in more detail the options. Premature decisions could lock in suboptimal outcomes as we have already said. We certainly hope that we could reach a consensus on the continuation of ESAF operations based on the Fund's own resources, which could be reflected in the Interim Committee discussions.

Mr. Dlamini made the following statement:

The staff has done a good job in outlining the issues to be considered in the process of adopting ESAF as the vehicle for the Fund's continued involvement in the poorest developing countries. My authorities are hopeful that today's deliberations will advance this process in order to give the assurance that the Fund will be in a position to continue supporting their economic adjustment efforts.

There are two mutually reinforcing considerations that form the background to our discussion. First, the experience gained since the establishment of ESAF in 1987 makes it clear that ESAF, distinguished by its concessionality and focus on medium-term reform, is the most effective way for the Fund to assist the complex process of adjustment in the low-income countries. Second, this lesson has translated into broad political support among the Fund's membership for the continued use of ESAF operations in low-income countries. This is evidenced by the communiqué of the Interim Committee following its spring meeting and the encouragement the Fund has received from the recent Summit of the Group of Seven major industrialized countries.

There is a growing recognition that the process of economic reform and adjustment in the low-income countries is a complex one that would inevitably take a longer time than initially envisaged. A major problem is the fragile nature of their economies that leaves them highly vulnerable to exogenous shocks, be it the weather or adverse movements in the terms of trade. Under the circumstances, a "self-sustained" ESAF is the appropriate way to proceed.

The question of when to establish a "self-sustained" ESAF is important. The choice is between establishing such a facility immediately after the resources of the present ESAF Trust are fully committed, or an "interim" ESAF to bridge the gap between the period when available resources are fully committed and before resources are retransferred into the SDA for a "self-sustained" ESAF.

The staff has suggested that an early "self-sustained" ESAF would suffer from the disadvantage of a relatively small size compared with an "interim" ESAF--about one half of the projected demand for ESAF resources over the 1999-1004. This weighs our judgment on the side of an "interim" ESAF because of the importance we attach to having adequate financing, the absence of which would jeopardize the sustainability and effectiveness of the adjustment programs. The smaller size of an early "self-sustained" ESAF is likely to create more difficulties if we considered the potential demand for ESAF resources by the three arrears cases that have been distinguished in the staff papers.

Funding options for an "interim" ESAF lead to the consideration of the use of the GRA to finance the loan component. We are inclined to supporting this proposition for two reasons. One is that bilateral contributions may need to be protected under ESAF Trust Reserve Account and, hence, substantially delay the start of the "self-sustained" ESAF. Second is the likely difficulty of mobilizing the required resources in the present climate of fiscal consolidation in major donor countries.

For the subsidy resources, the mobilization of at least one-half of the requirements from bilateral donors, including the use of part of the refund to them from SCA-2, should be pursued. It should be stressed that such assistance should not be a substitute for other bilateral aid flows to low-income countries. What we are seeking is additional resources consistent with the financing requirements of these countries. The consideration of a modest sale of the Fund's gold for the purpose of funding the other half of the subsidy element of the "interim" ESAF is consistent with the cautious attitude that the Fund has taken toward the use of its gold. It is also consistent with the purposes of the Fund. Besides, it should be noted that only the income from the investment of profits of the sale of gold would be used to finance the subsidy. The profits would be kept as part of the Fund's assets. Hence, the financial integrity of the Fund would not be threatened.

Let me turn briefly to some of the other issues for consideration. Regarding the question of access, we are aware that differentiation has been a standard practice. However, we have two concerns. One, the criteria for differentiating among eligible members have not been established, and we think that clear guidelines should be considered. The other concern is that it would appear that a number of eligible countries are likely to experience reduced access. This would make adjustment more difficult for these countries if, as is likely to be the case, they have a large financing requirement and donor assistance is not forthcoming on the scale expected.

Second, the idea of stocktaking after the implementation of a program supported by ESAF in the context of country strategy papers is something we could support, especially if the process of putting together such papers could be conducted in a transparent fashion with full involvement of the authorities in the ESAF-eligible countries. However, this should not be limited to ESAF-supported programs. Wouldn't equal treatment require that all Fund-supported programs be subject to stock-taking? Besides, periodic reviews are useful in that they would enhance our understanding of the intricacies of economic reform and adjustment which would benefit both the Fund and member countries. However, in conducting these reviews, we should ensure that the adjustment process is not interrupted.

Third, it is clear that the projections for the demand for Fund resources under the ESAF and the proposed "interim" ESAF can only be viewed as tentative. However, we would reiterate that the derivation of Fund financing, although balanced, has tended to be on the conservative side. The level of anticipated financing in percent of gross financing requirements for the eligible countries is virtually the same as what was attained in the period 1990-94, despite the poor prospects of donor assistance.

Fourth, as regards the proposal to extend ESAF maturities as suggested by Chancellor Clarke of the United Kingdom, we agree with the basic intention, which is, to ease the multilateral debt burden of heavily indebted low-income countries. In any event, what is important is that countries pursuing economic reform be assured of concessional financing over an extended period of time in order to relieve pressure on their balance of payments position, especially with regard to the debt service burden.

Finally, concerning the method of selling gold; we can go along with the auction approach.

Mr. Esdar made the following statement:

A discussion on a continuation of the ESAF, particularly the establishment of a self-sustained ESAF, raises too many complex issues and aspects, in particular, the very sensitive question of how the continuation should be financed. In this context, we may consider many options. Fortunately, the staff has helped to disentangle this very complex issue by providing us with three well-written and well-focused, but short documents. I would like to commend the staff for that, in particular for elaborating the different options and assumptions which facilitate putting the many stones together to form a mosaic with a clearer context.

Before I turn to detailed aspects, let me stress that we support the continuation of the ESAF and here I should mention that I have some problems with the word permanent. I think, in this world, really nothing is permanent. It should be permanent, but the word continuation may be more appropriate and would also meet the concerns of Mr. Kaeser.

We recognize that the adjustment programs under the ESAF have contributed to positive results in a number of low-income countries. Certainly, there are also ESAF-supported programs that did not achieve the desired results, but, in general, this was due to a lack of implementation of the agreed adjustment policies rather than to a basic flaw in the ESAF approach. The staff is seeking guidance for its future work, and I would like to group my comments in the following categories: the financing need, the continuation of ESAF, ESAF access policies, and options for a self-sustained ESAF. Let me summarize our position as follows:

First, we have the impression that the staff has over-estimated the future demand for ESAF resources. Second, we do not see a need for an interim ESAF. We favor starting with a self-sustained ESAF after the resources under the current ESAF are depleted. Third, access under the ESAF has to reflect the conditional and temporary character of this facility. Fourth, we support the proposal to use the resources of the Reserve Account for financing of the ESAF loan component. We are prepared to accept a reduction in the reserve coverage for ESAF creditors under the precondition that the residual will be covered by a gold pledge.

On the question of the size of resources required, in our view, the staff's assumption overestimates the financial need for the years ahead. While, in general, it is certainly true that demand for financial reserves is infinite by definition, when discussing the future role of the ESAF we have to pay due regard to the world economic outlook, the role and function of the ESAF, and the resources that could be provided under realistic assumptions.

With regard to the objective and role of the ESAF, I would like to reiterate that ESAF resources cannot be regarded as a permanent transfer mechanism like official development assistance (ODA) or IDA loans from the World Bank. Here, I strongly support the respective points of Mr. Bergo. To refer to net flows in this regard is, to say the least, misleading. I noted with considerable concern that the staff paper established a link between declining bilateral aid and access under the ESAF. ESAF resources are by no means an adequate substitute for ODA. As Mr. Kaeser emphasized, they should only be provided on a temporary basis with a clear expectation that the balance of payments situation of the countries concerned will improve to a more viable position, at least in the medium term. The related decision on the use of ESAF resources as reflected in the summings up of former ESAF policy discussions will have to remain valid and should be the basis for our future considerations.

Since its establishment in 1986, most of the eligible countries have used ESAF resources. Now, we should expect some positive results, at least in the medium term, and that the demand should be scaled back. Countries that have successfully performed under adjustment problems should be expected to graduate from ESAF, and as soon as their per capita income exceeds the IDA limit, they should lose their eligibility. The staff names three countries in this regard; over the course of time, we should expect additional cases to arise. Countries that do not perform adequately under agreed ESAF-supported programs should be aware that future access very much depends on a convincing reformulation of the policies demonstrated by a period of monitoring within the framework of a shadow program.

As to the question of access under a continued ESAF, in general, we do not see the need to change access limits, but actual average access should be expected to be reduced at least to some extent. The access for new debtors should be calculated as in the past, paying due regard to the strength of the program on a case-by-case basis, but not with the objective of substituting ODA reductions. Lower access should be provided for repeated users with a goal of phasing out. The idea of stocktaking seems to be very appropriate in this regard. There should be no financial support for those countries that fail to meet program standards, and there should be phasing out of ESAF eligibility for those countries that have attained the IDA per capita benchmark.

With regard to the proposal to blend ESAF resources with regular Fund resources for countries with higher per capita income, I have some doubts whether programs under the ESAF and the extended Fund facility are in general compatible. However, I am looking forward to the staff's reaction to Mr. Bergo's consideration in this regard.

I would like to add some remarks with regard to the treatment of the so-called highly indebted countries. We strongly support the staff's view that an extension of maturities for those countries would impose considerable problems not only for the financing of ESAF, but also for the principle of uniformity of treatment. Therefore, we are not in a position to support such an approach. We have discussed this issue in the past, and we have not changed our position on this.

In sum, the projected need of more than SDR 1.1 million in the interim period seems to be unrealistically high taking into account that disbursement of ESAF resources since 1988 have ranged between SDR 400-SDR 900 million per annum. In our view, potential flows in the size of SDR 600 million in the years ahead might provide a good starting assumption. This is certainly somewhat below the provided 800 million SDR calculated by the staff for the period after 1995. However, an extension of the ESAF to beyond 1999, which after the past experience does not seem unrealistic, would provide additional resources from the Reserve Account and there is always scope for the possibility of additional voluntary contributions. In addition, and in light of Mr. Bergo's point to review the extent of interest rate reduction, given the limited resources, we would recall our proposal to consider some form of interest rate differentiation for countries with higher per capita income, which would extend the scope for financing considerably. In our view, it remains difficult to justify countries close to the IDA benchmark expecting the same degree of concessionality as the extremely poor ones.

As to the procedural question, we are prepared to support the establishment of a continued ESAF based on the resources of the Reserve Account as soon as resources under the ESAF successor facility are depleted. We are prepared as well to accept a reduction of the reserve coverage of ESAF creditors to a ratio of 36 percent of outstanding obligations. In order to maintain the reserve requirement of ESAF creditors, we support the proposal to pledge part of the Fund's gold to re-establish the 100 percent coverage. The respective procedures are discussed in detail in the gold paper, and we can go along with the conclusions and the procedural proposals.

We do not see a need for an interim financing for ESAF. However, in case the Board should come to other conclusions, I would like to make some general remarks on potential financing options.

First, we strongly reject the idea of using the General Resources Account to finance the loan component of the interim ESAF. We discussed this issue in detail when establishing the ESAF successor facility, and the position of my authorities in this regard has not changed. The special character of the ESAF should be reflected in its financing, and should not be mixed up with the monetary character of the Fund's regular financing. Therefore, we do not see any advantage to funneling ESAF credits through the General Resources Account.

While we are prepared to accept the use of gold as collateral for ESAF creditors, we would object to the use of the investment income from profits of gold sales for ESAF subsidy resources. The use of gold as backup collateral would strongly limit the probability of an actual gold sale. At the same time, to sell gold for subsidies would create a precedent for other demands which could undermine the financial stability of this institution.

Finally, with regard to the comments of Mr. Autheman, I am certainly not in a position to change the opinion of the German

Parliament. I have some doubts whether it is realistic to expect that it will change its attitude toward ESAF-subsidies significantly. Our constitutional realities determine that the Parliament guides the Government. One can always strive to do it the other way around, but I am not very optimistic in this regard.

The Chairman noted that Germany had come forward with contributions for the first ESAF. At the time of the discussion of a successor ESAF facility, Germany had indicated that it would not be able to contribute to the Subsidy Account, because of the costs associated with the unification of the country. The international financial community had understood the constraints of dealing with a unique situation of historical importance to the country and to the world. However, the understanding had been that that situation would not last forever and that Germany would be in a position once again to discharge its international responsibilities. He would thus endorse Mr. Autheman's optimism regarding bilateral contributions.

Ms. Lissakers wondered how the sale of 5 million ounces of gold would jeopardize the financial integrity of the Fund, when the sale of gold in the 1970s had not had an adverse effect on the integrity of the institution.

Mr. Esdar remarked that a sale of even a modest proportion of the Fund's gold could set a precedent, and the Fund could be asked to sell gold to finance other operations. Suggestions had been made to sell gold in order to assist the highly indebted countries, to finance subsidies for an interim ESAF, as well as to pledge gold to provide security to creditors. At different international conferences, the use of gold had been proposed to deal with diverse situations, including Chernobyl and other environmental problems. He favored the staff's approach of a gold pledge because, under the scenario presented by the staff, it was unlikely that the Fund would be called upon to sell its gold.

Ms. Lissakers observed that the sale of gold in the 1970s had in no way threatened the financial integrity of the Fund, but had provided an essential facility that had enabled the poorer members of the institution to benefit from access to Fund resources.

After adjourning at 12:55 a.m., the meeting reconvened at 2:35 p.m.

Mr. Esdar remarked that if Reserve Account resources were used for the an early self-sustained ESAF, it would be necessary to find other ways of providing security to creditors for loans under the present ESAF. It was in that context that he had indicated a preference for using the gold pledge to provide insurance to creditors.

Mrs. Cheong made the following statement:

The staff has presented three comprehensive papers for today's discussions enabling this chair to easily formulate views on specific issues.

In considering access policy, I agree that there is a need for greater differentiation, based on the merits of each individual case. While access for repeat users is likely to be lower than for first time users, this should not preclude the Fund from providing higher access in support for appropriately strong programs. In this regard, it is important to recognize that the road to structural adjustment is a long one, requiring concerted policy reforms which may need to be phased in over the medium term, spanning several programs. Hence, repeat users should not be "penalized" or discriminated against. Indeed, for countries that faithfully complied with Fund programs, but continue to face balance of payments problems, any reduction in that country's access under subsequent ESAF-supported programs might be misconstrued as a lack of Fund commitment, or worse still, that the Fund is withdrawing support because something is amiss with the country's program. A case-by-case approach, based on merits of each situation would be more appropriate. Here, I support the call for staff reports to make more explicit recommendations on access based on some objective criteria to ensure even-handed treatment of members.

In principle, I can appreciate the staff's proposal to remove, from the ESAF-eligibility list, countries that have graduated from the IDA-eligibility list. Since ESAF is aimed to improve the economic conditions of the poorest countries, a review of the eligibility list is necessary to ensure that scarce concessionary resources are channeled only to those most in need. However, in doing this, we must exercise caution to avoid premature "graduation". Unlike IDA, the origins of ESAF is to resolve long-term balance of payments problems. Hence, graduation should not occur before the Fund has ensured that the improvement in a country's balance of payments position is sustainable and its capacity to service GRA credit is well entrenched. Further, we should probably also look for a track record of strong balance of payments position of at least 3 or 5 years before deciding on graduation. I look forward to staff comments on this issue.

In assessing the potential demand under the current ESAF, I note that the staff's background paper stressed that the projections are subject to considerable uncertainty, especially on the actual outturn of commodity prices and aid flows. More importantly, the projections for new commitments of SDR 5.1 billion are based on the assumption that access for most first-time users will be 120 percent of quota, while access for most repeat users has been assumed at 90 percent. In line with this chair's position that repeat users with strong programs should not be penalized in terms of access policy, I would appreciate staff elaboration on the implications on the potential demand for ESAF resources if we assume the same access level for repeat and first-time users of 120 percent of quota. Specifically, in this case, would the potential ESAF Trust resources of SDR 10.1 billion be fully committed before 1998? How would this affect the staff projections of SDR 6.9 billion in demand for new resources under an "interim" ESAF?

On the issue of the scope for a "self-sustained" ESAF, I share staff views that the starting point for such operations would depend critically on the continued maintenance of a strong payments record on SAF and ESAF loans. I can, therefore, go along with the proposal to defer the start of a self-sustained ESAF until 2005 or such time when the retransfer of resources from the Reserve Account to the SDA has reached the necessary "critical mass" to begin operations on a self-sustaining basis.

Under the financing options for an "interim" ESAF for 1999-2004, it would be preferable to finance new loans via GRA resources in order to avoid delays in the initiation of the self-sustained ESAF. The subsidy portion of the loans should ideally be provided by bilateral donors. However, in the face of declining aid budgets in recent years, it is necessary to finance such subsidies from the Fund's own resources. In this regard, it would be preferable to do so via the investment income derived from the profits on gold sales. Sales of gold will only represent a small proportion of the Fund's total gold holdings, and would be in line with the requirement to keep gold sales within the strictest limits. It is not as if we are proposing to auction off the "family silver". While I can appreciate concerns expressed by Mr. Kiekens, gold sales would be the most equitable and expedient means by which all countries will share the burden of assisting their poorest countries. In this regard, this chair strongly opposes any proposal along the lines stated in the last three lines of Mr. Bergo's statement as this move will represent a regressive step in our efforts to help the poorest members of this institution.

In the case of the financing options for a "self-sustaining" ESAF, the staff has indicated that it would be possible to begin SDA-financed ESAF operations in 2005. However, such operations would only be able to finance annual commitments of SDR 0.8 billion. In this regard, I join Mr. Berrizbeitia in seeking staff comments on the possibility of recycling the GRA resources that would be used for the "interim" ESAF to the "self-sustaining" ESAF.

This chair had previously supported extension of maturities for ESAF loans as a means of easing the debt burden of the poorest countries. However, like Mr. Mirakhor, I recognize that this approach may adversely affect graduating toward a self-sustaining ESAF. I would, therefore, agree to maintaining the current maturity structure of ESAF loans, provided there is favorable treatment of repeat users of ESAF loans.

Mr. Waterman made the following statement:

They say that time passes more quickly as you get older, and I think that must apply in my case because it seems only yesterday that we were considering the extension and enlargement of the ESAF. I suppose one reason I remember that so clearly is that it was a major achievement for this constituency to get some--admittedly small--contributions from a couple of member countries.

One of the difficulties that some members of this constituency have is that they do not see ESAF as fitting easily within the Fund's role as a monetary institution. Contributions to ESAF come from the aid vote, and where that is set in global terms, ESAF contributions generally reduce other aid payments, including to multilateral institutions, and that is at least from where we sit. It does not result in additional funding necessarily. As Mr. Clark and others have noted, pressures will remain on aid budgets and there will be demands coming on countries from other organizations, including importantly from the current IDA replenishment.

Having said that, at a personal level, I do not have any overly doctrinal views on the matter and belief that a case can be made for ESAF if it can be demonstrated that the Fund's involvement through the facility results in better macroeconomic policies in the poorer member countries than is likely to result through, say, channeling such subsidized financial assistance through the World Bank. But I make that point just to underline the importance at least to this constituency of ongoing evaluation of the effectiveness of ESAF and ability to demonstrate that in a sense we can get added value out of having such a facility in the Fund.

In that respect, I strongly support what Mr. Kaeser had to say about either a further internal or external review on the effectiveness of the facility. To my mind, ESAF has proved to be a useful facility for assisting the poorest members of the Fund, but significant further changes seem to be premature at this stage. The enlarged and extended ESAF has only commenced operations recently, and the changing figuring on possible future demands in the out years underlines the difficulty of projecting demands for ESAF resources. We would prefer to leave any decisions on transitional arrangements until the situation becomes clearer as to whether additional contributions are required. In that respect, I would join Mr. Esdar in noting that, in fact, if ESAF is successful, the demands on the facility should diminish somewhat over time. Having said that, we would be prepared to consider, at an appropriate time, using a further gold pledge to release part of the ESAF Reserve Account if that is necessary.

Finally, a few points of detail. We believe that access to ESAF should be limited to the very poorest countries and that the list of potential recipients should be reviewed to make it consistent with IDA eligibility or, alternatively, for the Fund to set its own benchmarks if that is the preference of members. In saying that, I accept that it would mean that a country coming from this constituency, like the Philippines, would probably drop off the list of eligible recipients.

On access, the Fund has adopted a sensible and pragmatic approach to date. We are rather cautious about raising access limits, but were this to be done, we believe it would need to depend importantly on the strengths of the underlying program, particularly if there is to be a blending of money from country contributions with that from GRA resources.

Finally, I agree with the reason the staff has given for not extending the maturity of ESAF loans.

Mr. Evans remarked that World Bank assistance was not enough to help the poorest member countries, and it was vital that the Fund also support the adjustment efforts of those countries. The ESAF was the most appropriate instrument to provide such support. Some Directors had mentioned the importance of establishing an independent evaluation unit in the Fund; the Group of Seven, at their meeting in Halifax, had made a similar proposal. He considered that that was a subject to which Directors should return in the future.

Mr. Waterman said that he agreed with Mr. Evans about the importance of an evaluation unit to monitor the effectiveness of the ESAF, because an assessment of the ESAF would determine whether there would be support for a continuation of the facility. As regards Fund support for the poorest member countries, he could envisage Fund involvement on macroeconomic issues, perhaps, in the formulation of the policy framework paper, but the actual financing of the program should be provided by the World Bank.

Mr. Evans noted that involvement in the policy framework paper would not be adequate, as there was a tendency on the part of all concerned--Directors, the management, and the staff--to pay more attention to a program that was supported with Fund resources than to one that was not.

Mr. Havrylyshyn made the following statement:

The important role that ESAF has played and should continue to play is not in doubt. This chair has and continues to be supportive of ESAF. The issues before us today have a genesis in the frequent proclamations about the declining availability of bilateral support for ESAF. I sympathize with the positive attitude of Mr. Autheman and agree one should not accept this as an irreversible reality--doing so could become a self-fulfilling prophecy. But since it will be some time before "aid-fatigue" is replaced by a renewed "aid-race", we do have an interim reality of declining bilateral support which leads to two key questions: first, should the ESAF be established on a permanent self-sustained basis? and second, how does one bridge the gap between the present ESAF and the self-sustained one?

On the first, this chair is certainly sympathetic to the idea of safeguarding the continued availability of ESAF-credits. However, the staff's calculations on a self-sustained ESAF show that for the time being, complete independence from donors remains a distant goal and make agreement on the gap-bridging difficult. The staff shows available resources under a self-sustaining ESAF would amount, at most, to a fixed nominal amount of SDR 0.8 billion a year from 2004 onwards. The staff document is unclear about whether this would be sufficient or not. Some Chairs have argued this is plenty and indeed we can move forward the date of the self-sustained ESAF. I would like to hear from the staff on how they compare this projected capacity of a self-sustaining ESAF to the projected ESAF-demand of SDR 1.5 billion from now to end-1998. If the need is even less, one could start earlier; but if the need is not less or even greater, the start is later and gap-filling needs to be done. I have presumed staff numbers are a middle scenario. The question then remains how to fill the gap. Various options are available, but let me echo again Mr. Autheman and say that one can add to Mr. Evans's useful list another--bilateral support.

Indeed it appears to me that in any realistic arrangement for ESAF, part of the medium-term ESAF-funding will have to come from bilateral donors. Although we agree that national budgets are coming increasingly under pressure, we feel it should be a never ending battle to persevere in the Fund's efforts to gather bilateral support for ESAF. In this light, at the Board discussion in April, a hopeful note was sounded as several of the largest donors and creditors to ESAF were also more explicit in voicing their support for ongoing reliance on such bilateral support. This is all the more important as we would join those who remain opposed to the use of GRA resources (for the loan element) or SCA-2 resources (for interest subsidies).

We broadly support the aims of Chancellor Clarke's proposal and favor use of investment incomes from the sale of part of the Fund's gold for financing the additional resources required for ESAF, but would like to stress the need for caution and restraint in the magnitude of gold sales - about a third coverage would appear a reasonable balance.

We would also favor further study on the possibilities of blending donor support with Fund resources from the Reserve Account. One could think of various options, one of which would be to postpone a self-sustained ESAF until the size of the Reserve Account is sufficient to provide more substantial annual commitments. This option would entail a distinctly longer interim period, necessitating reliance on additional donor funding during this time, but significantly less donor funding after the Reserve Account has matured. Another option would be to bring forward the mobilization of funds from the Reserve Account. This could be done by less-than-full reserve coverage. In view of the good payments performance of ESAF debtors to date, this does not seem imprudent. The advantage of this option would be that lower annual donor support is required in the short and medium term. The disadvantage would be that donor support would be required over a longer period of time.

We agree with the staff's proposal to apply more differentiation in access to ESAF credits between members, especially on the basis of member's ability to implement a strong adjustment program and member's debt servicing capacity. In doing this, our reading of the staff's proposal is such that increased differentiation will not lead to higher average access. The basic principle for allowing higher access in individual cases should remain the strength of the adjustment effort and the establishment of a serious track record. But in saying this we would certainly expect that the same applies to bilateral donor support, and we avoid situations where an already strong program is not adequately supported bilaterally, and can only go ahead through questionable and perhaps unrealistic further tightening of program measures.

Finally, let me say that we agree with the staff's proposal for the removal from the ESAF-eligible list of those countries that have already been removed from the IDA-list.

Mr. Saito made the following statement:

The ESAF is the most important financial instrument which allows the Fund to make an effective contribution to highly indebted low-income countries. In this connection, the continuation of ESAF operations is crucial to help poor countries in their adjustment and structural reform processes.

Let me refer, first, to some of the questions raised in the paper about ESAF, and second, to modalities for the use of gold.

As regards the assumptions on access for 1995-98, considering the uncertainties of aid resources and the heavy indebtedness of some countries I share the view that a more differentiated access seems appropriate in those cases where there is a balance of payments need and a convincing strengthening of the adjustment effort providing higher access within existing limits. Regarding a medium-term country strategy paper (CSP), I would prefer to improve the quality of the existing policy framework paper (PFP), instead of creating another report.

With respect to the possible changes to the list of ESAF-eligible countries, I cannot support the proposal to remove those members that have been--or are going to be--removed from the IDA-eligibility list. In the past, IDA-eligibility has been used as an indicator for SAF and ESAF eligibility. However, changes to the list of IDA-eligible countries have not had an automatic effect on ESAF-eligibility. In this regard, I share Mr. Berrizbeitia's suggestion that the Fund should establish its own criteria for determining ESAF eligibility. Moreover, considering the shortfalls of financing provided by the multilateral and regional development banks, we must be cautious in this issue and avoid jeopardizing the situation of a country due a temporary improvement in its per capita income, by excluding it for ESAF too early. For those countries which are in the process of graduation from ESAF and have not definitively reached the capacity to service non-concessional debt, a blending of ESAF with GRA resources through parallel arrangements may be a better option. This blending could allow greater access to ESAF resources, at the beginning, and replace them gradually with GRA resources.

With respect to a self-sustained ESAF, I share the staff's view that it would be preferable to defer the start of SDA-financed ESAF operations until the year 2005, and rely on an "interim" ESAF until then. For the loan component of interim ESAF, I agree with the proposal to use the resources from the General Resources Account. Regarding the subsidy account, let me turn now to the paper about gold.

On the issue of possible modalities for the use of gold in connection with a continuation of ESAF operations, I welcome the staff's latest illustrative paper. In this regard, I continue to support a cautious and prudent disposition of a modest amount of gold keeping in mind, on the one hand, the high opportunity cost of holding gold and, on the other, the need to safeguard its ultimate reserve role in the Fund. Similarly, I attach importance to avoiding ad-hoc decisions based on short-term considerations, and of sticking to straightforward and transparent modalities of implementation to ensure broad consensus and consistency with the Fund's purposes.

Having said this, the considerations given by the staff regarding the modality of possible gold sales, based on the Fund's own gold sales program of 1976-80, remain in my view valid. On balance, I share the staff's opinion that a preannounced schedule of public auctions of any significant quantity of the Fund's remaining holdings of gold would be preferable to sales to the markets through private channels.

Second, given the framework for the disposition of the profits realized from the sale of gold acquired before April 1978, this chair has generally gone along with the notion of using income from the investment of such "profits" to finance part of the subsidy requirements of an "interim" ESAF. I consider it appropriate that such "profits" be supplemented with bilateral contributions.

Some clarification from the staff would be appreciated on whether a decision to use only the income from the investment of the "profits" would foreclose any transfer of capital to the General Resources Account or for some other purpose of the Fund before the expiration of the "interim" ESAF operations and whether the special majorities required for such transfers would also apply to any investment income in the Special Disbursement Account in excess of the subsidy requirement.

Finally, the staff has provided a valuable insight into the workings of the gold pledge to finance the subsidy requirements of an "interim" ESAF or to allow for the commencement of "self-sustained" ESAF operations before balances in the Reserve Account exceed the liabilities of the Trust.

In this regard, I am not convinced that the involved negotiations over the amount of gold to be pledged, particularly in the latter alternative, would be conducive to a quick and broad consensus required for the continuation of ESAF. I would not favor a policy that would clearly lead to an increasing earmarking of the Fund's gold holdings and to reduced general backing of its assets.

Mr. Lanciotti made the following statement:

Let me start by reaffirming that the role of the Fund concessional financing has been important and is far from being exhausted. In my view, this is demonstrated by the continued challenges still experienced by the poorest developing countries and the positive impact that the recent implementation of structural reforms and stabilization programs in a number of those countries is having on the medium-term growth prospects.

Against this basically positive background, we must take stock of the experience gained so far by taking into due consideration the declining overall level of aid flows and the need for strong programs which are particularly ambitious in terms of promoting domestic savings and private sector development. Increasing effectiveness of Fund financing, which may be achieved by concentrating further on policies aimed at increasing productive capacity, will be important to enhance the Fund's catalytic role and mobilize external assistance.

These introductory comments lead me to give a positive answer to all of the first three questions made by the staff. A greater differentiation of access would contribute to improve cost-effectiveness of Fund financing along the lines mentioned above and, in the meantime, would better preserve the monetary character of the Fund by lowering, or denying, the use of Fund resources to those countries which cannot give satisfactory assurances of debt servicing capacity. This would be consistent with the strong conditional framework which must characterize Fund's financial assistance and with the general evolution of balance of payments support by other agencies and bilateral donors, which is concentrating more and more on those countries pursuing sound macroeconomic and structural policies. Therefore, in the presence of strong policies and adequate capacity to repay, I see no impediments to provide higher actual access within the existing limits.

I have already argued that a period of stocktaking between three-year ESAF arrangements may be helpful. This would allow both the Fund and the member countries' authorities to design policies better tailored to country-specific requirements and reinforce authorities' commitment, thus improving the degree of actual policy implementation. Regarding the proposal that the Fund could modify the list of ESAF-eligible countries, by removing those which are no longer IDA-eligible and have the capacity to service the debt deriving from the use of the GRA, I note that such a development would also be consistent with the need for greater flexibility, cost-effectiveness, and for coping with the phenomenon of an increasingly limited pool of resources available for balance of payment assistance.

As regards the estimate made by the staff concerning the order of magnitude of the projected demand for ESAF resources, I find it reasonable that the staff has postponed, by two years up to end-1998, the estimated date corresponding to the full using up of current ESAF resources.

Turning to the possibility of an "interim" ESAF, I believe that the potential of the ESAF to unfold as a permanent Fund policy is important and is worth exploration.

However, a careful consideration of the funding constraints for the new facility is crucial. In this respect, regarding the staff's assessment of the demand for ESAF under an "interim" period, I would have expected that the interim period was shortened and the overall funding requirements for the "interim" facility were diminished, due to the savings made on resources available for the current ESAF. A strengthened conditional policy approach by the Fund, as well as objective funding difficulties, would recommend to decrease the financing requirements for the "interim" period. For instance, assuming annual commitments of SDR 1 billion, as we did in April, the financing requirements for the interim period would total 8.5 billion, of which 6 billion for the loan and 2.5 billion for the subsidy components, instead of 9.8 billion.

In my view, further consideration of the technical modalities to finance the interim ESAF is conditional upon clarification of the order of magnitude of projected financing requirements. As for the possibility 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 lower than the present 100 percent coverage, this might be still worth of further analysis. The negative conclusions by the staff are based on a very low rate of coverage--36 percent--and it may be interesting to explore the possibility of a more prudent, but still lower than at present, coverage percentage, say 80 percent. This could contribute to reduce additional funding requirements during the "interim" ESAF and/or slightly anticipate the commencement date of the self-sustained ESAF, while, in the meantime, allows reasonable rate of coverage for ESAF lenders.

As for the sale of Gold, before examining the details of the staff paper, let me briefly recall the basic lines of the position expressed by this chair during the June 2 discussion on the role of gold in the Fund. While recognizing the importance of finding resources which may allow a continuation of the ESAF, our main concern regarding the role of gold remains that any disposal of gold may result in erosion of the Fund's assets and reduction of its creditworthiness. The unique role played by the Fund in the international monetary system requires that the availability of adequate, virtually untouched gold reserves is instrumental to such a peculiar function. Moreover, the Fund is a monetary institution and the role of gold for ESAF financing may be perceived by the market as not fully responding to the primary role of the Fund itself.

For these reasons, I would exclude the feasibility of Option A, namely the sale of 6.1 million ounces of gold--ranging upward to 8.8 million, including the arrears cases. Even if only the income from investment of profits were used, such an option would clearly contradict, in my view, the need both to minimize the reduction of Fund's gold holding and to preserve the perception of the Fund as a monetary institution and a last-resort guarantor.

Considering Option B, namely the gold pledge, the use of reserves from the ESAF Trust Reserve Account to finance part of the subsidy requirement during an "interim" period would be likely to imply only minimal gold sales, if any, particularly taking into consideration that the pledge is unlikely to be activated unless very widespread defaults occur with members meeting their obligations. I deem this possibility as being fairly remote, in particular in the context of a reinforced ESAF conditionality, as I argued earlier during the discussion on the adaptation of the ESAF. Therefore, the use of reserves to finance subsidies during an "interim" ESAF would appear to be feasible and would imply a modest pledge, if any, of 1.7 million ounces. This would also be consistent with the precedent of a gold pledge of up to 3 million ounces in connection with the encashment of rights under the Rights Approach, established in 1990.

On the contrary, with regard to an early self-sustained ESAF, I see no compelling need to reduce the rate of coverage of outstanding ESAF Trust liabilities to 36 percent. The resulting level of coverage would be rather poor and an actual use of the gold pledge would be anything but theoretical.

Mr. Zhang made the following statement:

At the outset, I would like to join the previous speakers in commending the staff for preparing such comprehensive papers on this important subject. We support the policy to strengthen Fund assistance to the developing members in the form of continuing ESAF. As confirmed by the Interim Committee and continuous support from the Board, the ESAF is an effective instrument for the Fund to use in contributing to the economic adjustment and growth of the poorest members, and the heavily indebted low-income developing countries, in particular. Given the changing conditions in member countries and the international financial market as a whole, consideration by the Board of adapting Fund policies on ESAF are warranted. For today's discussion, I would like to make the following remarks on the listed issues for discussion, which appear in the staff paper.

In light of developments in the international economy, it is appropriate and necessary for the Board to consider adaptations to the ESAF. The suggested differential treatment on the basis of specific performance and conditions is a practical alternative. In this connection, the blending of ESAF with GRA resources for those countries which are capable of absorbing international financial assistance under partially concessional terms, certainly allows greater access to concessional ESAF resources by other members in need. We share the staff concern that it would be important to examine carefully factors affecting a member's creditworthiness, including balance of payments prospects and debt-service obligations.

Although we support the view that the stronger programs the countries have the higher access they could have, I am of the view that countries who are unable to adopt a very strong program should not be excluded from having any access to the ESAF resources. I think this would be consistent with the spirit of uniformity of treatment. Furthermore, it will be very important for the Fund to work cooperatively with other international and regional financial institutions, especially taking into account that the Fund plays a catalytic role in bringing the financial resources into the country. Without the Fund's initial concurrence with the program, other institutions might not care to get involved. One of the goals of the Fund is to assist member countries in adjusting their economic structure and improving their balance of payments position. If the Fund can do its part, the developing members will find themselves in a much better position to overcome their economic difficulties.

Regarding the projections for potential demand under the current and the "interim" ESAF, I think the staff has established a reasonable basis for implementing and pursuing funding options.

Concerning the extension of ESAF maturities, I tend to agree with the staff analysis and conclusion. For the developing countries with heavy overall debt burdens and large liabilities to the Fund, an extension of ESAF maturities would not be sufficient by itself to meet their needs.

The paper on gold outlines the possible modalities of the use of a modest part of the Fund's gold on an illustrative basis which is very helpful in sharpening our discussion of the continuation of ESAF operations. First of all, I support the proposal that the ESAF subsidy resources be mobilized by 50 percent from bilateral donors and the other 50 percent from the Fund through selling a modest amount of gold. At our discussion on gold in the Fund on June 2, I shared the view of many other Directors that a sale of a modest portion of the Fund's gold would be justified both on the grounds of the cost of holding gold and in view of the need to help finance the ESAF. The illustrative simulations in the paper seemed to suggest that this view would be practical.

As indicated in the paper, if one-half of the subsidy requirement for all ESAF eligible countries, excluding three members in protracted arrears, were to be funded from the income on the invested profits of gold sales, sales of 6.1 million ounces of gold would be required; if the three members are taken into account, necessary gold sales would amount up to 8.8 million ounces, which accounts for about 8.5 percent of the Fund's total holdings. This figure represents a modest amount of the Fund's gold sales, which would have little effect on market conditions.

If the alternative way is considered, the amount of gold that would need to be pledged would depend on the particular method of supporting the "interim" ESAF, which ranges from 1.7 million ounces to 13.3 million ounces. However, this alternative way has its disadvantages and would not appear a satisfactory basis for self-sustained ESAF operations. Therefore, it appears that the first way of providing Fund resources to meet the subsidy requirements, i.e., the sales of a modest amount from the Fund's holdings of gold, and use of the investment income on the profits from these sales, would be preferred.

Regarding the modalities of the gold sale, we support the staff proposal that if agreement were reached for sales of more than very small amounts of the Fund's gold, consideration again be given for such sales to be made through "public" auctions of predetermined quantities of gold at specified intervals, along the lines of the gold sales program of 1976-80.

Mr. Estrella made the following statement:

ESAF lending is recognized as important for strengthening the economy of highly-indebted poor countries and post-conflict countries. We support greater use of this facility to assist these countries in strengthening their economies and coping with external shocks.

Regarding the role of the Fund in financing ESAF countries, we support greater differentiation of access. We agree with Mr. Berrizbeitia's suggestion that uniform criteria should be applied.

We think that reforms under subsequent ESAF arrangements can benefit from case-by-case analysis, to ensure that all policy levers are working or can work to deliver expected performance.

We sympathize with the idea that the Fund should establish its own criteria for removing a country from the ESAF's eligibility list. In addition, we strongly feel that such a removal should be a planned process between the Fund and the member country, especially in those cases where there are significant statistical changes. Such is the case of the Dominican Republic, for example. According to EBS/95/130, page 11, this country experienced a 60 percent increase in per capita GNP in U.S. dollars between 1990 and 1994--equivalent to about a 13 percent annual average increase--which did not necessarily reflect an improvement in the living standards of the population.

On demand for ESAF resources, we accept the underlying assumptions of EBS/95/130.

We can support the use of GRA resources for loans under an "interim" ESAF to avoid delays, given the good repayment record of ESAF borrowers.

The use of gold to finance part of the subsidy of the ESAF "interim" period is an issue that should be dealt with cautiously and should be analyzed in the context of the optimal composition of the Fund's portfolio. Perhaps a modest sale of gold by public auction will be a neutral way of supporting the continuation of ESAF operations. But, we should be aware that such a procedure could become a prelude to further use of the Fund's gold.

Mr. Al-Tuwaijri made the following statement:

At the outset I would like to compliment the staff on preparing an excellent and concise set of papers for today's discussion.

I will make only a few brief comments in response to the questions raised by the staff:

I share the staff's conclusions with respect to access to ESAF resources. I also agree that consideration should be given to the removal of countries from the list of ESAF-eligible countries following their removal from IDA-eligibility and a sustained improvement in their economic situation.

I share the conclusion of the staff that an extension of ESAF maturities would not be desirable. Indeed, we may have stretched the meaning of "making resources temporarily available" to its limit. Any extension of maturities would be counter to the monetary character of this institution and the revolving nature of its resources.

It is always difficult to come to a firm view on the potential demands for Fund resources. This is particularly true when projections are for a long period into the future. The staff paper notes that in the past we have tended to overestimate demand

and that ESAF resources will be available for a longer period than we initially assumed.

The continuation of making resources available under the ESAF is certainly desirable. The modalities for an "interim ESAF" presented in the paper, however, suggest that a number of difficult questions and issues will arise. In the circumstances, this chair will keep an open mind on proposals before us, but will reserve its position pending further discussions of the issues involved.

Mr. Vernikov made the following statement:

In view of the need for ESAF-type concessional operations, this chair would like to endorse a continuation of ESAF and its conversion into a self-sustained facility. We welcome the analysis undertaken by the staff in the well-focused papers. Being in broad agreement with the proposed ways of adaptation of the facility, we would thus give a positive answer to practically all the questions put forward for discussion.

Regarding financing of ESAF operations in the period 1999-2004, the most complicated issue is the subsidy component. We appreciate the staff's attempt at spelling out the existing options that envisage a combination of bilateral contributions and Fund's resources.

According to the mandate received from this Board, the staff has developed an illustrative scenario of gold sales to support an "interim" ESAF. This chair's long-held view has been not much in favor of gold sales. We should avoid any actions involving the Fund's gold which could undermine the financial position of this institution or destabilize the world market for gold.

On an earlier occasion, we have proposed to use for ESAF financing a part of the Fund's net income, since a change in the method of valuation of gold in line with GAAP would recognize a huge financial gain in the Fund's accounts and thus diminish the need to keep on accumulating precautionary balances at a high pace.

After our recent discussion on the role of gold in the Fund the Chairman concluded that "...any mobilization of the Fund's gold should result in a change in the composition of its assets rather than in an effective reduction". In this light, the staff might wish to explore acquisition of gold for ESAF Reserve as one of the possibilities.

When discussing a possible "early" use of resources from the Reserve Account, the staff has emphasized its disadvantages, the foremost of them being a lesser scale of ESAF operations. By contrast, Mr. Kiekens made a clear and reasonable point that we shouldn't discard this option at the present stage. Indeed, reality may push us toward some "hybrid" solution.

On balance, I believe that our discussion today has been very useful. It has brought us closer to practical matters related to a continuation of ESAF-type operations. I would encourage the staff to continue working on yet unsolved issues.

Mr. Mesaki made the following statement:

First, I would like to note that Japan is the largest contributor to ESAF and the successor ESAF facility, in terms of both subsidies and lending resources. This indicates my authorities' willingness to play a major role in supporting the economic development of the truly needy low-income developing countries.

Turning now to the issues for discussion, on the question of the differentiation of access policy, I can support the proposals from the standpoint of using Fund resources efficiently and giving user countries an incentive to adopt strong programs.

For similar reasons, we think that a period of stocktaking is a good idea, and would also provide a good basis for discussion of an ESAF successor.

Although there might not be much immediate merit in it, the idea of removing countries from the ESAF-eligibility list that have been removed from the IDA-eligibility list is consistent with our practice of relying on IDA-eligibility for the definition of low-income criteria and it would contribute to the efficient use of ESAF resources.

As for the assumptions on access for the period 1995-98, in light of the record of the previous period, we think they are appropriate.

Regarding the estimation of resource demand from 1999 to 2004, because there are a large number of uncertainties regarding the demand for ESAF-type resources under an "interim" ESAF, and because the estimated period is long, we should regard this estimation with a degree of skepticism, especially when considering the prospects of arrears countries.

With respect to the issue of the funding of an "interim" ESAF and the early initiation of a "self-sustained" ESAF, before we make a decision, we need to deepen our consideration of at least the following questions; indeed, it should be a prerequisite for our decision making. First, as other directors stated, 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 on a permanent basis? Second, what effect has the ESAF had on economic and structural reform in the user countries as a whole? We need a further comprehensive--internal and external--evaluation of the effectiveness of ESAF.

Based on these considerations, I will limit my comments on ESAF to the following two points.

First, on the issue of SCA-2, which the staff suggests can be a funding resource for the subsidy part of an "interim" ESAF, as this chair said at the April Board meeting, there are no convincing reasons why only SCA-2 contributors should be asked to contribute to ESAF and why their contribution should be the same 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 being refunded to the contributors, special legal arrangements by the respective parliaments would be needed.

Second, according to the staff paper, the reason an "interim" ESAF funded partly by the proceeds from gold sales would be better than early use of an ESAF Reserve Account is that the possible scale of a "self-sustained" ESAF from the year 2005 would be larger in the former case--SDR 0.8 billion--compared to SDR 0.6 billion in the latter case. We would like to note the following two points regarding this issue. Concerning the period of an "interim" ESAF, namely, 1999 to 2004, based on the estimated demand for ESAF-type resources, there would still be an unresolved funding problem with both an "interim" ESAF and the early initiation of a "self-sustained" ESAF. Also, the estimation itself contains a large degree of uncertainty. Moreover, the problem of ESAF-type lending after 2004, including the issue of scale, needs to be considered in the context of long-term demand for concessional lending and the significance of making ESAF-type lending a permanent scheme; and at this stage it is too early to decide the appropriateness of the scale of future ESAF-type lending.

As for the extension of maturity, we do not support this idea.

On the issue of modalities for the use of gold, first, I would like to note that in the previous Board meeting, there was broad agreement that any mobilization of the Fund's gold should be carefully thought out so as to avoid any weakening of the Fund's overall financing position. I understand that the staff paper was prepared on an "illustrative basis" to support our consideration of an ESAF-successor program. I would suggest that in addition to discussing the modalities for the use of gold we also need to continue our discussion on the significance of gold in the Fund.

Regarding the sale of gold by the Fund, we need to bear the following points in mind.

First, as this chair said at the previous Board meeting, the use of proceeds from gold sales will not cause pain to any member; therefore, if we decide to sell gold, it will be extremely difficult to set limits on subsequent sales.

Second, with respect to bilateral contributions to the ESAF and to the successor ESAF facility, I recall that we explained to our respective parliaments that bilateral contributions were needed as the sale of gold was not possible. If gold were made available, it could be argued domestically that our bilateral contributions should be substituted with the proceeds from the sales of gold, and this would cause an obstacle to the smooth disbursement of our contributions, as Mr. Autheman mentioned. On this point, I understand that the Managing Director suggested that by setting a ratio between the amount of the bilateral contributions and the amount realized from the sale of gold, we could avoid possible domestic arguments. It seems to me, however, that this argument is not strong enough to convince domestic opinion, which might say that the amount of bilateral contribution should be minimum as long as gold sales are possible. This point is very important because we would need additional bilateral contributions if we take an option of "interim" ESAF.

Third, I note that if the Fund were to sell its gold, its creditworthiness would lessen and its ability to respond to unexpected events would be damaged.

As for a gold pledge, I think the Board should consider it very carefully, bearing the following points in mind.

In the staff paper, early use of the ESAF Reserve Account was possible by the gold pledge reducing the coverage ratio to 36 percent. There is no discussion in the paper, however, as to whether this ratio is sufficient to secure our credit to the ESAF Trust in light of the possibility of future arrears to the ESAF and the time required to sell gold. In other words, I would suggest that the appropriateness of a specific coverage ratio from the standpoint of securing our credit to the ESAF Trust needs to be considered further, and until this is done, we cannot judge the appropriateness of a gold pledge.

I would add that as the largest contributor to ESAF, Japan has a strong interest in securing its credit to the ESAF Trust.

As the staff paper notes, a gold pledge must be decided specifically by a majority of 85 percent of total voting power. Moreover, I note that the basic problem with gold sales is also applicable to a gold pledge.

Finally, the staff paper notes that it is expected that ESAF-eligible countries could be allowed to use resources of the successor ESAF facility until at least the end of 1998, so there is time for a thorough discussion of this issue, presuming that gold is not sold. At this stage, it is too early to reach a conclusion.

Mr. Mohammed made the following statement:

Let me at the outset reiterate our firmly held view that the rationale for a continuation of the ESAF is sound. As noted by the staff, the case for continuation is made all the more pressing by the large number of member countries for which the facility is expected to continue to be an indispensable vehicle for Fund support.

On the key issue before us, let me make the following comments. First, we continue to believe the basic model for the ESAF continuation, which was proposed last spring by the Managing Director, remains viable. Thus, we continue to support the concept of an interim ESAF, leading to a self-sustaining operation.

Second, we also continue to be willing to support the sale of Fund gold to finance, through income on the profits from the sale, half of the subsidy requirements of the interim ESAF. As to the second half, we continue to have misgivings about the utilization of possible SCA-2 refunds.

Third, as noted by Mr. Kiekens, the pace of utilization of ESAF resources has been consistently overestimated. i would note, however, that the staff's current projections on utilization over the period 1999-2004 are based on the Fund's actual relative contribution to the financing requirement over the period 1990-94. Moreover, against the backdrop of a regrettable tightening of bilateral aid budgets and concomitant pressures on the Fund to increase its contribution, we should, if anything, be careful not to err on the low side. We have to ensure that the Fund will be in a position to respond effectively to the needs of its low-income members, including those currently in arrears.

Fourth, I share the views expressed by Mr. Kiekens on the question of stock-taking between successive three-year ESAF arrangements. ESAF operations are based on a medium-term framework that is continually updated in the context of the PFP process. If there is an evident need for stock-taking between three-year arrangements, this could suggest the PFP process itself may need to be looked at, with a view to improving it further.

Fifth, we agree with the staff's conclusion regarding the retention of existing ESAF terms. Of the reasons given by the staff in support of this conclusion, I believe the resource constraint argument merits full consideration. Considering the difficulties envisaged in raising resources to finance ESAF operations on existing terms, there is no reason to believe that there will be enough resources to finance extended maturities. In any event, let me make it clear that we will not support a gold sale in amounts that exceed what is needed to provide half of the subsidy requirement for an interim ESAF on existing terms.

With regard to the operational issues before us, let me make the following brief comments.

We agree broadly with the considerations concerning access suggested by the staff, with two nuances. First, decisions on "low or no access" must be approached with extreme caution and sensitivity to all relevant considerations, including their possible adverse catalytic implications. Second, the considerations suggested by the staff will most likely result in access becoming more differentiated in terms of quotas than in the past. This is acceptable. But, care must be exercised to avoid the possibility of what is likely to be a byproduct (namely, greater access differentiation) itself becoming a guideline.

We can agree with the proposal to consider removing countries from the ESAF eligibility list following their removal from IDA-eligibility, provided that they have reached a sustained improvement in their economic situation.

Mr. Geethakrishnan made the following statement:

We take it for granted that the Fund will exist on a long-term basis and also that it would be able to provide short-term balance of payments support, when necessary, to needy members. What is now under examination is whether we could put ESAF, a concessional facility to the poorer members, on a more permanent basis. As Ms. Lissakers had pointed out, ESAF has helped a large number of developing countries to tide over balance of payments problems and put through macroeconomic stabilization efforts and structural reforms. As such the proposals for putting this concessional facility on a more permanent footing deserve support.

Various nomenclatures have been used in this connection, ESAF III, interim facility, permanent facility, self-sustaining facility, etc., etc. What is important is not the nomenclature but the contents, whether we will be able to ensure that adequate loan amounts, with the required degree of concessionality would be available on a continuing basis.

The term self-sustaining has a special meaning. It is like the Unilateral Declaration of Independence by Rhodesia (UDI), whereby the Fund tells its members that it is able to continue the ESAF on its own without further resources support from the members. It is fine if this is possible. But there is no merit in premature unilateral declaration of independence, if it should result in either the loan amount or the concessional element becoming less. Wisdom lies in continuing to get the resources support of the members and also exploring all other avenues for supplementary resources, until the time is ripe. Rushing into self-sustaining ESAF without adequate preparations could be counterproductive in that it could send diametrically opposed signals about the Fund's abilities to provide the required order of resources and that too with necessary concessionality.

The basic point is that we need to mobilize more resources before the self-sustaining stage is reached. Support from the donor community, supplemented to some extent by contributions from some emerging economies is what has made ESAF I and ESAF II possible. This support was important not only from the point of view of raising resources, but more importantly served as a signal of commitment of the vast majority of the members to supporting the less fortunate members. It is therefore necessary that there should be no let up in these efforts in the interim period between the coming an end of ESAF II expires to the end of ESAF II to the time when it would become self-sustaining.

However, taking into account the difficulties faced by many countries in being very generous with their purse strings at a time when they are also constrained to put their major fiscal consolidation measure, it would be in order to reduce the pressure somewhat by raising part of the resources through utilizing the return from investment of the proceeds of limited gold sales and by using the surpluses in SCA-2 as an when these arise. The gold pledge is only half an option, in that it does not meet even half the requirement, and is therefore not worth pursuing.

So I support the proposal to make ESAF permanent; and for bridging the interregnum before it can become self-sustaining in a full pledged manner, through contributions from members, gold sales, SCA-2 surpluses, and transfers from other reserves.

The Chairman remarked that a number of Directors, in calling for a continuation of the ESAF, had noted that the continued availability of ESAF resources would benefit greatly the low-income countries that were heavily indebted to multilateral institutions. Thus, it was not accurate to say that the Fund had lost sight of the original purpose of the discussion on the ESAF.

Mr. Geethakrishnan stressed that, although other Directors had not supported an extension of maturities on ESAF loans, in his view, it would be appropriate to extend maturities in some cases. He fully supported the Fund's efforts to help the heavily indebted low-income countries both through its surveillance exercises and through ESAF-supported programs. The Fund's activities in that area supplemented the efforts of the World Bank and bilateral donors. He wondered whether, in addition to such efforts, the Fund could also find some way of alleviating the multilateral debt burden of those countries. It was in that context that he considered it appropriate to consider not refunding the surpluses from the second Special Contingent Account. He suggested that using the refunds of the second Special Contingent Account and the proceeds from the sale of gold should be considered as a way of waiving the debt, or at least extending the maturities of ESAF loans for some countries. Furthermore, by using those resources, the entire membership would be involved, not just a few members--as was the case with the ESAF Loan Account, which was funded primarily by France and Japan.

Mr. Berrizbeitia observed that all Directors had supported a continuation of the ESAF, although they had differed about the details: some had favored an interim ESAF from 1999-2004, while others had favored bringing forward to 1999 the date of a self-sustained ESAF. He wondered whether it would be possible for the staff to combine Directors' suggestions. According to the staff, an early use of the Reserve Account would mobilize SDR 600 million for an early self-sustained ESAF; he wondered whether those resources could be combined with resources of the General Resources Account and with bilateral contributions. Those resources could support financing of SDR 1.3 billion per year, at the same time reducing the requirements for overall financing, including financing of the subsidy component of the ESAF. Furthermore, he asked whether a sale of about 6 or 7 percent of the Fund's gold would strengthen or weaken the Fund's financial strength as perceived by markets. It was true that holding gold had psychological value as well, but he wondered whether the psychological impact of selling gold could be offset by the effect of increasing the Fund's liquidity, particularly as the Fund would only be utilizing the proceeds from gold sales. He asked whether the Articles of Agreement would permit the Fund to buy back, say, in a few years when donor contributions resumed, some of the gold it was considering selling, particularly as the price of gold had been relatively stable.

The Deputy General Counsel remarked that, if the Fund were to sell gold, the equivalent of SDR 35 per fine ounce from the proceeds would have to be placed in the General Resources Account, and the remainder would be placed in the Special Disbursement Account. The Fund was not authorized to buy back gold. The Fund could accept payment in gold at the value of the market price only in operations and transactions authorized under the Articles.

Mr. Kaeser said that he was surprised that the possibility of creating SDRs instead of selling gold to finance the ESAF had not yet been mentioned.

Mr. Mesaki observed that in 1976 the Fund had decided to sell gold in the context of strengthening the role of the SDR.

The Director of the Policy Development and Review Department observed that, in the period 1988-94, lending under the ESAF had been about SDR 1 billion a year. For the period 1995-98, the staff estimated that demand would be about SDR 1.5 billion per year. This was broadly consistent with demand in recent years, but had taken account of the assumption that Zambia would complete its rights accumulation program and enter into an ESAF arrangement, as well as other factors, such as the demand for concessional assistance from the CFA franc zone countries and the transition economies, both of which would probably be requesting ESAF resources in the period 1995-98. There were a number of countries that were eligible for ESAF resources and had not drawn upon them, but could do so in the future. In the past, a number of countries had combined concessional resources--ESAF arrangements--with general resources--stand-by arrangements--and some ESAF-eligible countries had relied only on stand-by arrangements. Looking to the future, the staff assumed that ESAF-eligible countries would not be requesting use of the Fund's general resources, but would rely on the Fund's concessional assistance only.

The estimates for the period beyond 1998 were much less specific, the Director continued. The staff had based its projections of demand for ESAF resources on potential demand in the 1995-98 period, as well as on estimated demand from those countries that would be clearing their arrears, that is, an annual increase in demand for ESAF resources to SDR 1.8 billion. The estimate for a self-sustained ESAF of about SDR 800 million annually from 2005 onward was not based on the potential demand for ESAF resources, but was a calculation of the amount of resources that would be available for a self-sustained ESAF following an interim ESAF. The projections appeared to be reasonable, particularly as the expectation was that the performance of countries would improve over the next decade, with some countries graduating from the ESAF-eligibility list, and others relying on programs that blended nonconcessional and concessional resources.

The staff was not suggesting a change in access policy under the ESAF, the Director stressed. Access policy governing the use of ESAF resources was similar to the policy for the General Resources Account, namely, access was determined by the balance of payments need of the country, the strength of the program, the amount of outstanding Fund credit, the country's track record with the Fund, and its debt-servicing capacity. The staff was emphasizing that those countries with strong programs should be given higher access, as the Board had generally agreed. It was also suggesting that other countries should strengthen their programs, because, in an environment of declining bilateral aid flows, donors and creditors were targeting their support to countries with strong programs. In addition to receiving bilateral support, countries that adopted strong programs would also have higher access to Fund resources. The real problem lay with countries that adopted weak programs. It was difficult to envisage how the Fund could support these countries in the absence of a credible effort to strengthen their programs and in the absence of bilateral support. For those countries, the staff was proposing that a period for monitoring the program to enable the country to establish a track record and attract bilateral support, thereby paving the way for an ESAF-supported program, would be appropriate.

It was difficult to assess whether the more complex reforms that repeat users of ESAF resources would be implementing required higher access than the staff envisaged, the Director considered. Although the authorities would continue to need external support in the later stages of reform, which included privatization, financial sector reform, and downsizing of the government, it was not clear whether the amount of support would be greater than during the early stages of reform. The staff was not suggesting that the Fund get involved in issues that fell within the domain of the World Bank, but the staff considered that, in designing a comprehensive program and the policy framework paper, it was important to take into account the linkages between the various reforms.

The Director remarked that the advantage of using the IDA list to determine eligibility for ESAF resources was that there was a consensus that the countries on that list were in need of concessional assistance. In the past, Directors had felt that the number of lists of countries eligible for concessional assistance from multilateral institutions should be limited. The IDA list had been useful to the Fund, but the Board had reserved the right to add to that list countries that would be eligible for ESAF resources. The staff was proposing that the Board use the IDA-eligibility list as a guideline in determining the ESAF-eligibility list, while at the same time, reserving the right to alter the list. If the staff proposed that countries be dropped from the ESAF-eligibility list, the Board would have a chance to review the case, based on consultation with the staff and the Director concerned. All discretion about determining the ESAF-eligibility list would rest with the Board.

The issue of whether a country should have parallel arrangements through the use of the General Resources Account and the ESAF was also a question of determining eligibility for concessional resources. In that context, he would note that it was extremely difficult to establish objective criteria to determine which countries should be charged a higher interest rate, and which a lower rate; if such a determination was based on per capita income alone, for example, the countries that fell into each category would not necessarily be those that other factors may suggest. The countries that had availed themselves of general and concessional resources in parallel arrangements--to date, only Pakistan and Zimbabwe--were countries that had had access to private capital markets, but had also been in need of concessional assistance.

As regards gold sales and bilateral contributions for the subsidy component of the interim ESAF, the Chairman had proposed in April that one third of the subsidy requirement be met through bilateral contributions--through the refund of contributions to the second Special Contingent Account--and the rest by the Fund through the sale of a modest portion of its gold, the Director recalled. At that time, and again during the current discussion, a number of Directors had felt that bilateral contributions should be higher than what was envisaged. Some Directors had been, and continued to be, opposed to gold sales. On the basis of the discussion in April, the staff was proposing that about one half the contributions come from bilateral sources, and the other half from gold sales. Only the income from the investment of a modest portion of the Fund's gold would be used to meet the subsidy requirement.

By providing an estimate of the resources necessary for a "permanent" ESAF the staff was not suggesting that an individual country would be permanently relying on ESAF resources, the Director noted. The staff was stating that, for the foreseeable future, the Fund should have the ability to meet the needs of its poorer member countries with concessional resources.

The usual review under the Article IV surveillance process and under the program reviews permitted the kind of stocktaking that the staff was proposing, the Director considered. Introducing a system for evaluating a country's performance in intervals between arrangements would provide an opportunity to take a longer-term, objective assessment of the program. The staff paper on growth response to adjustment programs had shown that there was an intricate and complex relationship between a country's macroeconomic situation and its structural adjustment. It was necessary to pause between programs to assess the effects of adjustment on the economy, in particular to re-examine the assumptions of the program and to try to explain why the expected results may not have materialized. The intention was not to pause for two years between arrangements as some Directors had inferred; however, to evaluate effectively the program, a short assessment between one three-year arrangement and the next was necessary. It could be expected that for a country whose program had met expectations and where the reviews had been successfully completed, the period between the completion of the review of the previous annual arrangement and the completion of that arrangement might suffice for such stocktaking. However, in those countries where a program had not achieved the expected results or where a program had gone off track, it would be necessary to have a longer stocktaking period. In the past, in those countries where the program had gone off track, the Fund had established a shadow program, to help re-establish a track record. The staff did not consider that a period of stocktaking would be disruptive.

Ms. Lissakers asked why it would not be possible to assess a program's strengths and weaknesses during the regular reviews of the program.

The Director of the Policy Development and Review Department replied that, in principle, it was possible to asses the program in the course of the regular reviews. However, programs were often not continuous. For instance, it was not uncommon for the authorities to discontinue the program and then to indicate suddenly their willingness to restart a program. In those circumstances, it was difficult to take stock of the program's successes and drawbacks. Furthermore, often, the history of the country's economy--in terms of the relationships between variables and elasticities of variables--which were necessary for a complete assessment of the program--was incomplete. The staff expected that stocktaking would provide an opportunity for the staff to reassess the assumptions on which the original program had been based, an appraisal that was not always possible during the regular program reviews.

Mr. Geethakrishnan observed that his office had been assessing the impact of the programs over the past 15 years in the countries of his constituency. On the basis of that, he had concluded that, unlike the earlier period, when the Fund had focused mainly on the balance of payments position of countries, in recent years the Fund had begun to focus on the entire macroeconomic situation prevailing in the country concerned. In light of that, he considered that it was possible for the staff to assess comprehensively the country's overall progress in the course of the regular reviews.

Mr. Esdar remarked that it was his expectation that a country that had entered into a number of ESAF-supported programs would, eventually, see an improvement in its macroeconomic situation, and would therefore be less reliant on ESAF resources. On the basis of that, he had considered the staff's estimates for potential demand to be on the high side, and was disappointed by the fact that the staff expected future use of ESAF resources to be higher. He recalled that, a few years before, at the discussions on extending the ESAF, the staff had considered that a number of countries would successfully implement ESAF-supported programs and that it would be feasible to phase out use of ESAF resources in the future. However, as the current discussion indicated, that was not the case. In light of that, he considered that it would be necessary for the staff to take stock of programs in individual cases, to understand why the programs had not lived up to expectations.

Mr. Kaeser asked how many ESAF arrangements, on average, a country would need before the adjustment process was successfully completed.

Mrs. Cheong considered that the staff's estimates of higher use of ESAF resources was not surprising because there were a number of countries that would become eligible for concessional assistance in the future. She recalled that, between 1993 and 1994, 3 of the 11 countries in her constituency--a high proportion--had availed themselves of ESAF resources.

Mr. Geethakrishnan commented that the adjustment process for developing countries was a long one, and one should not expect immediate results. Even industrial countries, which had a sound track record, took some time to adjust to economic shocks; thus, it was important to be patient with developing countries.

Mr. Esdar remarked that he agreed that the transition economies would need to draw on ESAF resources. He considered that the staff should have indicated separately the demand for resources by first-time users--that is the transition economies and some developing countries--and the anticipated lower demand from countries that were expected to successfully complete the adjustment process. He agreed that developing countries would need concessional financing. The question was whether the Fund, through the ESAF, should be providing that financing. Industrial countries were willing to support the adjustment efforts of developing countries; the issue facing them was how best to channel their scarce resources. From the perspective of industrial countries, the funding for ESAF had to be addressed in the context of funding for other concessional facilities of different multilateral institutions, such as the World Bank's IDA facility, which also merited support from industrial countries.

The Chairman commented that Mr. Esdar's remark on industrial countries' financing of concessional facilities was important; at a time when development assistance was declining, donors wished to provide resources to those institutions--and those facilities--which they considered would best promote the adoption of sound policies. That was a difficult judgment, and it was understandable that some Directors considered that bilateral contributions would not be forthcoming. However, he recalled that in 1987, during the discussions relating to the creation of the ESAF, a number of Directors had expressed the view that financing for the facility would not materialize, and, yet, funding had been provided and the Fund had succeeded in catalyzing sound policies and financing. The Fund made every effort to limit its drawing on the scarce resources of bilateral donors; he had not hesitated to propose the sale of a modest portion of the Fund's gold to assist the poorer countries. It was important that bilateral donors recognize the importance of financing an interim ESAF, and he was confident that such financing would come through.

The Director of the Policy Development and Review Department observed that the staff had not assumed that individual ESAF users would make greater use of ESAF resources, but that the number of countries qualifying for ESAF resources would increase. Under the current ESAF, about 37 of the 81 ESAF-eligible countries had drawn upon the facility. The staff's projections of demand for ESAF resources from 1998-2004, were based on the assumption that a number of program countries would not be requesting further use of ESAF resources. In that context, he considered that it was difficult to assess the time frame for demand of ESAF resources. There were some countries whose economies had responded positively to the adjustment process, while others had reacted slowly, partly owing to factors beyond the authorities' control, such as the situation of the world economy or the political situation in the country. Experience had shown that one three-year ESAF arrangement was inadequate; a succession of two or three ESAF arrangements was needed to bring about deep, long-lasting structural changes in the economy. In addition, a significant political commitment was required to implement the more complex reforms of the later stages of adjustment.

As regards the implications of financing ESAF loans from the General Resources Account, that depended on whether the General Resources Account was used to finance new loan commitments or existing arrangements, the Director considered. If the General Resources Account were used to finance new commitments, Fund support would be under an extended arrangement; if the General Resources Account were used for an arrangement already agreed, it would be necessary to redo the arrangement or conclude a new arrangement. It followed that, if the General Resources Account were used, that account would also provide security for such loans, thereby freeing up the Reserve Account. Such an option had implications for the rate of charge and burden sharing, as well as on the risk of default. The risk of borrowers defaulting rested with the membership when the General Resources Account was used, but rested with the poorer members when ESAF Trust loans were used, because surpluses in the Reserve Account were to be re-transferred to the Special Disbursement Account for use by poorer members. If financing were made available through the General Resources Account, it would free up resources in the Reserve Account, which would make possible earlier use of that account to finance a self-sustained ESAF, thereby shortening the period for an interim ESAF. In addition, if the staff was overestimating the potential demand for ESAF resources, the resources of the current ESAF would last longer, shortening further the period of an interim ESAF. However, under the schemes outlined, no additional resources would be generated.

Mr. Berrizbeitia observed that, according to the staff's estimates, about SDR 600 million could be mobilized from the Reserve Account to finance an early self-sustained ESAF, leaving about SDR 300 million in additional financing for a loan commitment of SDR 1.2-SDR 1.3 billion per year. The staff envisaged that the loan commitment under an interim ESAF would be about the same amount. The purpose of combining resources would be to lower the amount of additional funding necessary, and to find other ways--perhaps gold sales--to finance the subsidy component. Thus, the overall availability of resources would not be lower, but the additional financing necessary would be lower.

The Director of the Policy Development and Review Department observed that early mobilization of the Reserve Account would mean less protection to loan contributors, which might limit bilateral contributions, and would require greater reliance on the General Resources Account for additional financing. While a number of combinations were possible, the problem was that use of the resources of one account affected the resources in other accounts, often adversely.

If access for repeat users was raised from 90 percent of quota to 120 percent, the loan commitment under the present ESAF would increase by SDR 1 billion, which would bring forward from end-1998 to mid-1998 the period of the present ESAF, the Director noted.

The Deputy Treasurer remarked that the staff would be issuing a paper on the liquidity position of the Fund. The impact on the Fund's liquidity of using the General Resources Account to finance the loan component of the interim ESAF would depend on the size of the Fund's resources, which would be affected by the quota increase under the Eleventh General Review. The staff was projecting that the liquidity ratio would be about 100 percent at the end of the year and that for every SDR 1 billion in commitment the liquidity ratio would fall by 3 percentage points. Those projections were subject to change, depending on the Fund's resources.

If the loan component of the interim ESAF was financed through the General Resources Account, the repayments of those loans would flow back into the General Resources Account and would not increase the availability of capital for the self-sustaining ESAF, the Deputy Treasurer noted. Although those reflows could be used again to finance loans under ESAF-type operations, they would not be directly channeled into the self-sustaining ESAF Trust.

As long as only the income from the investment of the profits of the sale of gold was used to finance the subsidy requirement, the financial position of the Fund would remain basically unchanged, the Deputy Treasurer continued. It was difficult to gauge the reaction of markets to the Fund's sale of gold, particularly whether a sale of a small portion would be seen as the beginning of a disposal of the Fund's entire holdings of gold.

Mr. Evans said that he agreed that it was difficult to judge the reaction of markets. He recalled that the sale of the Fund's gold in the late 1970s had not raised any questions about the financial strength of the Fund.

The Deputy General Counsel noted that after a gold sale, the excess above SDR 35 million would be placed to the Special Disbursement Account. The Board would only decide to invest those amounts held in the Special Disbursement Account and on the use of the income from such investment for purposes of assistance. The use of the principal would remain undetermined and a decision would need to be taken at a future time; the Board could either make a transfer to the General Resources Account--a decision that required a 70 percent majority of the total voting power, or it could decide to use the amount for developing countries in difficult circumstances--a decision requiring an 85 percent majority of the total voting power. The Fund's treatment of the principal at present and at a later date, when the investment was no longer needed for subsidy purposes, could be a relevant factor in the market perception.

On the issue of "recycling" of repurchases in the General Resources Account, the Fund had no power to make a transfer of currencies to the Special Disbursement Account, the Deputy General Counsel continued. The Fund could, for investment purposes, transfer currencies to the investment account, but it could not make a transfer to the Special Disbursement Account or to a trust for purposes of providing assistance to a limited number of countries, as would be the case under the ESAF. Moreover, the Fund had no power to transfer net income to the Special Disbursement Account or the ESAF Trust. The use of the currencies in the General Resources Account and of the net income generated was limited to the purposes of use in the General Resources Account and the Fund had no power to add any other uses and purposes to those that were specifically prescribed in the Articles. The issue of whether a uniform criterion could be found that would allow the Fund to make available assistance on longer maturities to a narrowly defined group of countries, that is, countries indebted to multilaterals, depended, first, on the form of the financing of particular transactions for those members, the Deputy General Counsel considered. If resources were provided from the General Resources Account, the rules of the General Resources Account would apply. Alternatively, if resources from the Special Disbursement Account were used, the rules of the Special Disbursement Account would be applicable. If the extended arrangement were used for the interim ESAF, the Fund could not establish a sub-repurchase period under that facility; repurchase periods under the extended arrangement would need to be the same for all of the extended arrangement users. The Fund could establish special facilities, but a special balance of payments problem would be involved. The fact that a member was indebted to a multilateral institution would not constitute a special balance of payments problem. A particular creditor relationship would not constitute a special balance of payments problem; countries indebted to bilateral or commercial creditors were as exposed to debt and debt service payments and their effects on the balance of payments as members that were only indebted to multilateral institutions; the multilateral debt criterion would exclude these countries facing similar balance of payments difficulties. In addition, any use of General Resources Account resources must be temporary and the Board had set ten years as the limit for temporary use of resources.

Under the Special Disbursement Account, a list of developing countries that could obtain assistance under special conditions could be established, the Deputy General Counsel continued. Eligibility must take into account per capita income. However, assistance under a facility or extended maturities would also need to be uniform, and the considerations outlined for the General Resources Account would apply in the Special Disbursement Account context as well. Moreover, since resources from the Special Disbursement Account were used for the ESAF reserve and subsidy accounts, *uniformity would also apply in the ESAF context. In short, the criterion of* multilateral debt would not be a relevant distinguishing factor, because it excluded countries that, as far as their debt profile and balance of payments situation were concerned, could be in a comparably difficult situation to those exclusively indebted to multilateral institutions.

Mr. Geethakrishnan observed that the Fund had created a facility--the ESAF--for a particular group of members of the institution. He asked what changes in rules and procedures would be required to address the problems of a subset of those countries, namely, those heavily indebted to multilateral institutions.

Mr. Evans remarked that the problem of multilateral debt was serious and members were committed to alleviating the problem of heavily indebted countries. Although continuation of the ESAF would assist those countries, it would be insufficient and other mechanisms were necessary to solve the problem of debt to multilateral institutions.

Mr. Autheman observed that, while some Board members considered that the problem of multilateral debt was a special problem requiring special attention, others considered that, as much of that debt was on concessional loans and as the bilateral and commercial debt of those countries was not substantial, the problem of multilateral debt was not as significant a problem as the overall indebtedness of some developing countries. He could not subscribe to the view that the issue of multilateral debt had not been acknowledged.

Mr. Evans commented that Mr. Autheman's authorities had stressed the problem of multilateral debt at the Halifax meeting of the Group of Seven, and had urged the Fund and other institutions to address the problem.

The Chairman remarked that, although the multilateral debt of some of the African countries was serious, an even more important issue was to put the African economies on the growth trajectory. In the past, a number of Directors had cautioned the Fund against involvement in development issues, arguing that such issues fell within the domain of the World Bank. The Fund was committed to solving the problem of multilateral debt and would cooperate and work closely with the World Bank and other multilateral institutions to address the problem of those countries, but it could only do so in a manner that was consistent with the monetary character of the institution.

Ms. Lissakers said that, although she agreed with the Chairman, she considered that, because the obligations to the Fund constituted the debt burden of some of the countries, no other multilateral institution except the Fund could address the problem in those cases. The modalities of alleviating the problem could be discussed, and could be designed in a manner consistent with the monetary character of the institution, but the problem of debt to the Fund could not be ignored by the institution.

The Chairman remarked that he agreed with Ms. Lissakers. He had emphasized that the Fund could only act within the boundaries of a monetary institution. The Articles of Agreement contained provisions for addressing debt problems of members, which should be considered before considering other options.

Mr. Esdar and Ms. Lissakers recalled that the Halifax communiqué had also said that the Bretton Woods institutions assist countries with multilateral debt problems through existing instruments, and "new mechanisms where necessary."

Mr. Geethakrishnan commented that he did not agree with Mr. Autheman that the issue of multilateral debt had been addressed effectively. He asked the staff whether any of the existing rules and procedures could be changed in order to deal with the problem. He recalled that, during the discussions on SDR allocations, the Board had been willing to consider the U.S./U.K. proposal despite the fact that that proposal entailed an amendment of the Articles.

The Deputy General Counsel noted that the rules of the Special Disbursement Account were contained in the Articles. The commentary clarified that use had to be uniform. Therefore, amendments would be required. However, it was important to keep in mind that the origin of those resources was the Fund's gold, mainly derived from contributions of the membership through subscription payments before the Second Amendment. References to uniformity, quota-based distribution upon liquidation, and to members on August 31, 1975 could be explained in that context.

The Chairman made the following summing up, which was agreed at Informal Session 95/9 (9/12/95):

> This discussion has been constructive in advancing our work--as mandated by the Interim Committee--on the options for continued financing and adaptation of the ESAF. I am gratified by the consensus that exists for the continuation of the ESAF, including the establishment of a self-sustained ESAF, a necessary instrument to assist a large number of our poorest member countries, and I understand the centerpiece of any Fund strategy when dealing with the problem of countries that are heavily indebted, including to multilateral institutions. We have discussed several important issues which I will attempt to summarize under four headings: access and eligibility; potential demand for drawings under the ESAF; extension of ESAF maturities; and financing the interim ESAF, including possible modalities for the use of gold.
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> Access and eligibility are two main factors bearing on the likely pace of use of ESAF resources. On access, there was broad support for the conclusions outlined in EBS/95/130. Directors broadly agreed that it would be appropriate to allow greater differentiation in access based on balance of payments need, the strength of the adjustment effort, the track record on use of Fund resources, the amount of outstanding Fund credit, and debt-servicing capacity. Directors stressed that access recommendations should be set in a clear, objective framework that ensured evenhandedness. They asked that staff reports supporting requests for ESAF arrangements be more explicit than in the past on the considerations underlying recommendations on access in individual cases.

Most Directors favored that providing resources of the ESAF and the General Resources Account through parallel arrangements should continue to be an option for those countries that have the capacity to service nonconcessional debt; a few Directors also suggested the possibility of differentiating interest rates as an alternative to, or in conjunction with, such parallel use.

In the context of a continuation of ESAF operations, there was also broad agreement on the usefulness of stocktaking, on a case-by-case basis, toward the end of a three-year ESAF arrangement to reflect on what has been achieved and how to ensure strong performance in a subsequent arrangement. Several speakers made the point that it would be wise to try to do so in the context of the reviews under the existing arrangement.

With respect to ESAF eligibility, Directors generally agreed that it would be appropriate to consider removing from the ESAF-eligibility list countries that were no longer eligible for IDA resources, and were judged to have the capacity to service Fund credit from the General Resources Account. The staff will shortly prepare a proposal on this for consideration by the Executive Board.

With regard to the staff's updated analysis of likely demand for ESAF resources during the period 1995-2004, several Directors believed that the potential demand had been overestimated. Nevertheless, on balance, Directors generally took the view that the staff's calculations provided an acceptable, possibly conservative, starting point for our further deliberations.

On a possible extension of maturities under the ESAF for selected countries facing heavy debt obligations to multilateral institutions, and especially the Fund, most Directors agreed that, in view of the monetary character of the Fund, it was preferable to continue to provide ESAF resources on present terms. The view was held that there was a potential trade-off between lengthening of maturities and continuity of ESAF. It was generally agreed that this continuity had the distinct advantage of allowing the maintenance of an ongoing conditionality dialogue. As requested by several of you, we will nevertheless continue to work actively, particularly with the World Bank, on the issues that arise in our efforts to address the debt-service burden of heavily indebted countries; such efforts will need to be pursued within the framework of the Fund as a monetary institution.

On the financing of the loan component of an interim ESAF, most Directors reiterated their support for the use of resources of the General Resources Account, recognizing that new bilateral loans could raise the issue of how to provide protection for such claims, and that if such protection were made available through the Reserve Account, this would substantially delay initiation of operations under the self-sustained ESAF. However, a few Directors opposed the use of the resources of the General Resources Account for ESAF operations.

Several speakers considered that, if the pace of use of currently available ESAF resources was slower than currently projected--that is, lasting beyond end-1998--there would be a reduced need for an interim ESAF, which could possibly be met through an earlier use of Special Disbursement Account resources than possible under the current provisions governing balances in the Reserve Account.

Directors observed that financing the subsidy element of the interim ESAF represented a major challenge. Many Directors considered that using income from the investment of the profits from the sale of a modest proportion of the Fund's gold--where possible in combination with resources of the Reserve Account and bilateral contributions--to finance the subsidy requirement for an interim ESAF would help the adjustment efforts of the Fund's poorest members and, therefore, would be well justified in terms of the Fund's purposes. These Directors noted, moreover, that the Fund would retain the profits from gold sales, thus basically safeguarding the financial position of the Fund. Views varied within this group of Executive Directors between those considering that gold sales was the most realistic option given the difficulty of securing new bilateral contributions in the present budgetary environment in many donor countries, and those insisting on limiting to a strict minimum the gold contribution to preferably well below 50 percent of the amount required. However, it is clear from today's discussion that there is not at present the broad consensus that is required for sales of Fund gold.

Other Directors reaffirmed their opposition to considering sales of gold, or did not see a compelling case for the Fund to sell gold at the present time as there were other means of financing an interim ESAF or permitting an early initiation of a self-sustained ESAF. For example, some Directors would be prepared to contemplate the use of part of the balances accumulated in the Reserve Account, provided that any reduction in the balance of the Reserve Account of the ESAF Trust would be offset by a pledge, that is, a decision by the Fund to sell an equivalent amount of gold if this should become necessary to meet the Trust's maturing obligations. Many Directors, however, were concerned that early use of the Reserve Account would reduce the size of the self-sustained ESAF. Moreover, the required majority of 85 percent of the voting power in favor of pledging part of the Fund's gold also does not exist at the present time.

Some have insisted that budgetary constraints could, in the near future, limit bilateral contribution for such purposes, many of you today have stressed the common responsibility of the international community to support the adjustment efforts of the poorest countries, and expressed the hope that bilateral contributions would eventually be forthcoming to help finance the subsidy requirement for a continuation of the ESAF, which might also facilitate moving toward a consensus on gold. Accordingly, I have suggested that the Fund provide no more than one half of the resources required for subsidies. Also, as mentioned in the staff paper, balances accumulating in the Second Special Contingent Account, which now have reached slightly more than SDR 800 million, could be considered for this purpose once they are no longer needed to provide protection for rights-related purchases, which, as some Directors noted, may be some time in the future. I have noted the request of several of you for the staff to study possible ways of utilizing amounts in the Second Special Contingent Account to assist in the financing of the ESAF, while taking due consideration of the legislative or other constraints of the contributors to the Second Special Contingent Account.

Let me end these broad conclusions from today's discussion with the following observations. First, the Executive Board is agreed that we must be prepared to help meet the future balance of payments financing needs of our least advantaged members, including those with a heavy debt toward multilateral institutions. Continuation of ESAF-type operations has been supported by all today, and we must ensure that we have the resources necessary to fulfill that responsibility. Second, as you know, I personally join the view of those Directors that consider justified the sale of a modest amount of the Fund's gold to support a continuation of ESAF operations in strict parallelism with at least a similar effort by bilateral contributors. From the views I have heard today with regard to the sale of gold and bilateral contributions, I submit for your further consideration that we will need to look for a compromise position that involves a contribution by the Fund and by individual members in a spirit of evenhandedness and fair burden sharing. Third, the staff indicated in the papers before us today that, under the assumptions made in the paper, a self-sustained ESAF that can commit only SDR 600 million a year would not appear sufficient to meet members' projected needs. I have heard other views today. However, we do need to secure financing for continued ESAF operations beyond 1998 at levels that can be expected to make a substantial contribution toward a solution of the problems of low-income countries, and I believe we should come to an early decision on this matter. I would also note that some Directors emphasized that we continue to work toward reaching our target for the funding of the present ESAF. We should return to advance our consideration of all these issues after the October ministerial meetings, utilizing all the suggestions made to get the appropriate funding solution.

The Chairman, replying to a question raised by Mr. Evans, said that the summing up would be transmitted to members of the Interim Committee, and it would also be part of his oral report to the Committee. In addition, he would report on the Board's discussions on the ESAF to the Development Committee.

The Director of the Policy Development and Review Department noted that the Chairman's oral report on the Board's discussion of ESAF to the Development Committee would be particularly relevant because the Committee would be discussing IDA and multilateral debt at its restricted session.

4. FUND INVOLVEMENT IN POST-CONFLICT COUNTRIES

The Executive Directors considered a staff paper on Fund involvement in post-conflict countries (EBS/95/141, 8/16/95).

Mr. Mesaki made the following statement:

> I would like to begin by addressing the most basic question with respect to Fund involvement in post-conflict countries (PCCs): whether the Fund should change its existing framework and prepare special instruments in order to provide financial support to PCCs at an earlier stage. I doubt that it should, although I concede that the Fund's early financial involvement in the reconstruction process of PCCs would strengthen its position in connection with economic reform and that the staff's proposal has some merit. In my view, it is sufficient to use the existing framework flexibly for the PCCs, for the following reasons.
>
> First, as the staff says, so far the Fund has been able to provide financial support successfully at a relatively early stage and has contributed a great deal to the reconstruction process of PCCs. Although some of the PCCs benefited from the STF, which has now expired, I do not think that the differences between the STF and the first credit tranche arrangement regarding maturity and access would have mattered in the reconstruction process. I believe that early Fund's involvement is crucial, and the first credit tranche could be sufficiently effective for that purpose.
>
> Second, we should give careful attention to consistency between the staff's proposal and the Fund's monetary character. In this light, while the Fund's early involvement in the reconstruction process may be needed in some PCC cases, the extent of the role that the Fund can play should be carefully examined. I believe we must be cautious about increasing the exceptions to

the Fund's basic role of providing short-term balance of payments assistance with strict conditionalities.

In the context of explaining the necessity for a new arrangement, the staff says that "a first credit tranche purchase or arrangement might be a possibility, but in some instances the member might not be in a position to formulate and implement the requisite program." I believe, however, that it would be inconsistent with the monetary character of the Fund for the Fund to provide assistance to countries that are not capable of formulating a program that meets the standard of a first credit tranche arrangement. Is that not what other aid agencies should do?

I believe that financial assistance to PCCs at an initial stage should be provided in the form of grants or highly concessional assistance by bilateral donors and aid agencies.

In this connection, we should first clarify the role of each agency, especially the Fund, the Bank, and the UN, in providing financial and technical assistance to PCCs before considering new, special assistance by the Fund. The recent Group of Seven (G-7) Summit in Halifax called on the Bretton Woods institutions and the UN to establish a new coordination procedure, supported as necessary by existing resources, to facilitate a smooth transition from the emergency to the rehabilitation phase of a crisis and to cooperate more effectively with donor countries. The communiqué emphasized "a new coordination procedure," not a new financial arrangement.

Turning to the modality of the proposed new mechanism for assistance to PCCs, that is, expanding the scope of the present emergency assistance policy, as I emphasized earlier, I am not convinced by the argument for the proposed new arrangement and believe that it is premature to discuss it. However, just in case the majority of the Board supports the staff's proposal, I will make some comments on the modality of the new mechanism. As I can broadly support the staff's proposals in this respect, I will be brief.

First, I fully agree with the staff that the use of ESAF resources is not appropriate because it would entail a basic departure from the structure and objectives of the ESAF.

Second, the staff paper says that the "conditions would include a statement of economic policies, including a quantified macroeconomic framework to the extent possible, and an expressed intent to move as soon as possible to an upper credit tranche stand-by, EFF, or ESAF arrangement." Although I have no difficulty with this, I would emphasize that this condition should be strictly applied. It would not make any sense if the Fund requested a member without minimal administrative capacity for such commitments. In such cases, financial assistance should be preceded by technical assistance.

Third, regarding access, the staff paper says that "the access potentially available under the existing policy on emergency assistance--normally up to one credit tranche--may be appropriate....However, higher access can be provided exceptionally under the policy and this could also be appropriate in some post-conflict cases." In order to safeguard Fund resources, access should be strictly limited to one credit tranche and exceptions should be granted only in truly extraordinary cases.

Fourth, regarding interest subsidies, the staff paper says, "some of the countries that might make use of emergency assistance in post-conflict situations may be ESAF-eligible, and it may be desirable for some of these to seek sources of subsidy in conjunction with the use of the Fund's general resources under the emergency assistance policy. One approach could be to seek subsidies on a case-by-case basis...." This would seem to suggest that the proposed scheme is a kind of new ESAF-type facility which uses GRA resources with very weak conditionality. In light of the Fund's catalytic role and its monetary character, we should be very cautious in considering such a scheme. It would not be appropriate if the proposed scheme were systematically incorporated into the new financial arrangement for PCCs as an essential part of it. At the same time, even if the Fund seeks subsidies on a case-by-case basis, as currently envisaged by the staff, almost all the PCCs would request the interest-subsidy scheme once it was established. As a result, it would be extremely difficult to apply the interest-subsidy scheme selectively to PCCs.

In conclusion, I would like to reiterate that it is premature to discuss a specific new financial arrangement for PCCs. Priority should be given to establishing a new coordination procedure to help PCCs among the international organizations.

Mr. Havrylyshyn made the following statement:

Mr. Mesaki's statement reflects much of what I would have wanted to say, so I can be brief and focus on two issues: coordination; and expanding emergency assistance policy.

On coordination, the staff paper makes clear that the Fund has been playing an important and valuable role in post-conflict situations. The Fund staff and management have shown an ability to provide technical assistance and policy advice in an early stage, and move to programs.

The paper makes also very clear that each specific post-conflict case is unique, which uniqueness makes it, in my view, inappropriate to establish a uniform institutional coordination approach. What international institution will take the lead-role in what specific case should depend on the specific circumstances, and thus a case-by-case approach remains the most appropriate. In any event I would not favor an "automatic" lead-role for the Fund in all or even most cases.

As regards expanding the scope of the emergency policy, the uniqueness of each specific post-conflict makes it quite difficult to establish guidelines for financial support from the Fund. The current policy of emergency assistance has the advantage that it is rather clear in which situations (namely, natural disasters) such assistance can be given. Consider what we mean by "post-conflict" situations. First, this is the first time we see a definition of this (p2 para 1) and presumably there is scope for evolution and specificity on this definition. Thus, as Mr. Mesaki suggests, it may be premature to look for concrete solutions to not yet fully defined problems. Second, the definition given includes a characteristic common with "natural disaster" situations (item (ii): need for speedy assistance), but it also includes a characteristic which completely differentiates post-conflict from post-disaster situations: (item i): severely impaired administrative capacity). Until we see a further evolution of the definition, this last characteristic argues very strongly against simple expansion of the present emergency facility.

Thus this chair is not very enthusiastic about such an expansion of the present emergency policy for two reasons. First, in principle the Fund should be reticent in providing too hastily balance of payments support where adequate conditionality is difficult to put in place. Technical assistance from the IMF seems to be the most important and most valuable contribution to countries with weak administrative capacities. Technical assistance in the fields of institution building and policy design paves the way for a regular Fund program once initial political and economic stabilization has been achieved. To the extent that Fund involvement is considered important as a catalyzer for support from other multilateral and bilateral donors, it should be possible for the Fund to strive to play its catalytic role by designing and monitoring a shadow program in the initial phases after conflict.

Second, post-conflict countries generally will have only a very limited debt-servicing capacity, and thus I wonder whether it is very helpful for them to be provided with relatively limited, nonconcessional Fund support. The main sources of financial support should come concessionally from bilateral donors, the World Bank, and regional development banks.

Let me conclude in a forward looking way. I do not underestimate the tremendous importance of an effort by the international community to move more quickly and in a more co-ordinated fashion in post-conflict situations. We need to continue thinking about and looking for innovative ways to improve strategies for such cases, but we are not yet there. In the meantime we need to remain sensitive to such cases and react quickly, even more so than we have done so far in the several cases described in the Staff Report.

The Chairman asked what Mr. Havrylyshyn considered the Fund should do to provide timely assistance to countries emerging from chaos.

Mr. Havrylyshyn replied that it was important to be forward looking and to seek an innovative approach to assist those countries. The staff's paper was a first step in that direction, and the staff should continue its exploratory efforts to look for innovative ways for the Fund to assist post-conflict countries. He considered that technical assistance could be provided in a timely manner; and, as had been the case with the systemic transformation facility, technical assistance should pave the way for an appropriate Fund-supported program under existing facilities as soon as possible.

Mr. Wei made the following statement:

At the outset, I would like to thank the staff for preparing this helpful paper for today's discussion.

Firstly, I agree with the staff on the definition of post-conflict countries, namely, those countries that have been affected by profound domestic or international unrest. In such cases, their administrative capacities have been severely impaired, and so it is very difficult for them to implement comprehensive macroeconomic and structural adjustment programs. When we discuss the issues of the Fund involvement in post-conflict countries, we must bear in mind the special circumstances of such countries.

Secondly, we support the Fund's playing an active role in assisting the PCCs to overcome their economic and social difficulties at an early stage. The experiences of the Fund's involvement in the five countries presented in the paper are very useful. One of the common problems these countries face is that economic growth, particularly foreign trade, has been disrupted and official reserves have declined to extremely low levels. In this context, it is appropriate and necessary for the Fund to extend financial assistance to address their balance of payments needs and technical assistance to help them in improving their institutional capacity.

Thirdly, on the issue of coordination of assistance, I fully share the staff's conclusion that coordination between the Fund and other institutions, especially the United Nations, as well as bilateral donors should be continued and strengthened. We agree with the staff that this process of coordination has benefited from the leadership of a single agency which, in the case of a bilateral donor, due to its historical, political, or economic links with the country concerned, or in the case of a regional development bank, due to its large scale of lending or geographical convenience to that country, usually has the advantage to play such a role. Therefore, we believe that the institutional flexibility in the process of coordination is appropriate and should continue.

Lastly, on the issue of Fund financial involvement with PCCs, it is our view that the PCCs will benefit more if the Fund could provide financial assistance to the PCCs at as early a stage as possible because such assistance from the Fund could catalyze support from other institutions or bilateral donors. As I mentioned before, due to the insufficient administrative capacity of PCCs, it is not realistic for the Fund to expect a PCC to design and embark on a comprehensive economic adjustment program in order for it to receive the Fund's financial assistance under the existing facilities. Therefore, we encourage the staff to explore the possibility of expanding the scope of emergency assistance to accommodate the needs of PCCs.

On the access issue, we can agree that up to one credit tranche is appropriate at the initial stages. However, we believe that higher access should be considered in exceptional cases. We also share the view that for those ESAF-eligible PCCs, subsidized resources could be sought on a case-by-case basis in conjunction with the use of the Fund's general resources under the emergency assistance policy.

Ms. Lissakers made the following statement:

I find it somewhat ironic that 50 years after the founding of this institution and related institutions, we are debating our involvement in post-conflict situations, since the Fund, the World Bank, and the United Nations really were created originally to deal precisely with post-conflict reconstruction, rehabilitation, and reform. In the event, bilateral assistance dominated the immediate post-World War II period and these agencies moved on to other issues. But the fact is that multilateral institutions are now being asked to take the lead in addressing these situations, and I think we all agree that the current ad hoc approach is not optimal. We need better coordination and some clear ground rules for dealing with these situations, and we clearly need some streamlining and perhaps modification of procedures and policies in the individual institutions, including this one. We have coped with the challenges in the past but sometimes only by stretching the limits of established policy and procedures that could have set some unfortunate precedents. We think it would be preferable to look squarely at the sorts of circumstances we are dealing with and modify, where necessary, our processes and policies.

It is clear that many post-conflict countries will have a limited capacity to implement comprehensive policy measures as we require under a standard stand-by arrangement or extended arrangement or even ESAF. Such countries will be faced in many cases with urgent balance of payments and other financing needs which would require perhaps some front-loading, and for a time may have severely constrained debt-servicing capacity. We think the staff has outlined a reasonable response and modification of the existing emergency mechanism in a prudent and measured manner that could provide a sort of glide-path approach modeled on the very successful systemic transformation facility to give us the capacity to respond quickly and smoothly and efficiently in these circumstances as they arise. I was, frankly, a little surprised to hear a representative of one of the beneficiaries of the systemic transformation facility question the need for some improved modalities for these post-conflict situations.

We agree with the basic elements of the emergency assistance that could be appropriately provided by the Fund as outlined by the staff. Eligibility should be limited to situations involving balance of payments financing need and limited capacity to implement economic policies that would be required by a stand-by arrangement or an ESAF. Access should be limited certainly, although we would prefer to rely on the Fund's annual and cumulative access limits, with actual access based on a case-by-case assessment of particular situations, rather than having a one-size-fits-all presumption, in combination with the exceptional circumstances clause. Financing terms should reflect the financing need and the possible limited debt-servicing ability of the post-conflict countries. Thus, as I said, large upfront disbursements may be needed. Interest subsidies by donors would certainly be desirable, but may be difficult to mobilize. So, certainly consideration should be given to replacing this initial emergency mechanism financing with ESAF resources as quickly as possible. Moreover, given the inevitable uncertainties in determining whether a post-conflict country is ESAF-eligible, for example, due to lack of current data to determine per capita income, some flexibility on that standard may be desirable.

Conditionality should reflect the borrower's capacity to implement policy measures, but also should reflect the commitment to adopt a comprehensive stabilization and adjustment program that meets normal Fund criteria at an early date. A policy framework paper type document would be useful in providing a comprehensive country strategy, and would also be a useful mechanism in coordination among the agencies in laying out clearly what is needed from each participant.

We hope that this discussion will form the basis for a positive recommendation to the Interim Committee and the staff could proceed to develop a fully articulated proposal for the Executive Board to consider following the Annual Meetings.

Mr. Havrylyshyn stressed that he was not opposed to the provision of assistance to post-conflict countries. He had only questioned whether the Fund's emergency assistance policy was the appropriate instrument and had suggested that the staff continue its search for innovative ways to assist those countries.

Mr. Bergo made the following statement:

I would like to commend the staff for producing a useful and well-written paper.

As is evident from the paper, the Fund has been actively involved in all the cases reviewed, having a key role both in the provision of early technical assistance and policy advice, and in providing financial assistance at a relatively early stage.

This involvement has certainly been important, especially to the extent that it has helped to speed up stabilization and the process of initiating more comprehensive reform, which seems to have been the case in general. Close coordination between the various institutions and bilaterals is certainly important, but the present arrangements have generally worked well. Experiences gained over the recent years do not indicate a strong need to devote substantial resources to develop a more precise framework for the coordination of the assistance, technical as well as financial, to post-conflict countries.

While the analysis underscores the importance of clear and strong leadership in the coordination effort, it also shows that no single institutional formula would seem applicable and appropriate to all cases. Thus, we should retain appropriate flexibility to deal with the specifics of the individual case in an efficient manner.

I would, however, like to emphasize that this chair finds that the organization of assistance to post-conflict cases does not belong to the primary tasks of the Fund. Furthermore, experiences in the five post-conflict countries where the Fund has been involved recently do not indicate an obvious need for the Fund to take on an increased financial role in such cases. Any involvement by the Fund should, to my mind, follow a very cautious approach in light of the uncertainties involved and the likely limited repayment capacity of such countries. Moreover, I find it essential that the Fund avoid going into the development assistance sphere as well as into other institutions' areas of competence. The Fund activities in assisting post-conflict countries must not jeopardize its monetary role. Accordingly, I am in full agreement with Mr. Mesaki that we must be cautious about increasing the exceptions to the Fund's basic role of providing short-term balance of payments assistance with strict conditionality, and that it is questionable if it is consistent with the monetary character of the Fund to provide assistance to countries that are not capable of formulating a program that merits the standard of a first credit tranche arrangement.

Against this background, and even if it cannot be totally excluded that broadening the scope of the policy on emergency assistance to include post-conflict cases may help such countries to initiate the process of solving macroeconomic and balance of payments problems at an early stage, and help to catalyze financing at the very early start of the rehabilitation phase, this chair is skeptical to the proposal of providing financial assistance from the Fund to post-conflict countries through a window under the emergency assistance policy.

However, I find it essential for the Fund to continue and, if needed, to strengthen its technical assistance and its policy advice for such countries. It is indeed a central role of the Fund to assist in restoring the basic institutions of economic management and to assist in the development of a program that merits financial support from the Fund. With proper emphasis on this dimension, it may furthermore be possible to shorten the period until such support can be considered under the existing array of facilities.

Should the proposal to include financial assistance to post-conflict countries under the emergency assistance policy gain sufficient support, I have much sympathy with the comments made by Mr. Mesaki in his statement on the possible modalities. I believe that the volume of lending in no way should go beyond 25 percent of quota. Moreover, disbursements should be tranched in accordance with experiences gained as regards each member country's willingness to cooperate with the Fund in addressing its problems, and in order to give incentives to the early elaboration of a more comprehensive economic program.

The Chairman asked Mr. Bergo to explain further whether Fund lending in post-conflict countries should be tranched.

Mr. Bergo considered that lending should be in two tranches.

Mr. Shields made the following statement:

As Mr. Mesaki reminded us in his statement, the recent G7 Summit in Halifax called on the Bretton Woods Institutions and the UN to establish a new coordination procedure, supported as necessary by existing resources, and to cooperate more effectively with donors. The emphasis, as Mr. Mesaki pointed out, was on coordination and cooperation. This must be our fundamental concern. Nevertheless, given the Interim Committee communiqué of a year ago and our discussion in the spring, it is appropriate that the staff has also looked at ways in which the resources of the Fund could be used to speed up the recovery phase and ensure that such recovery becomes fully sustainable within the context of our responsibilities as a monetary institution.

The staff paper provides examples of different arrangements that have existed in alternative crisis situations and the various roles played by different international institutions. There should be no hard and fast rules as to which institution should be in the lead--and clearly it is more likely to be the World Bank, a Regional Development Bank, or a UN institution agency other than the Fund on its own, but it is crucial to identify at the outset which institution that should be. Once that has been agreed, the lead institution can be relied upon to coordinate effectively, including, of course, with the major bilateral donors and creditors. This needs to proceed under an agreed common policy framework supplemented by comprehensive and detailed plans. But we need to see whether the World Bank agree with us on this and to proceed in tandem.

During the very early stages of recovery, the main role of the Fund must continue to be the provision of technical assistance and policy advice. As the staff paper makes clear, this has played a vital role in previous post-conflict situations and is a crucial element in rebuilding administrative capacity to implement a full recovery program. In all the major areas--fiscal, monetary, exchange rate and statistics--Fund support has provided an essential counterpart to assistance also being provided by the World Bank, and generally by the UN and other multilateral and bilateral bodies.

There has also often been timely Fund financial support. But we accept that in the future there would not always be a potential for Fund financial assistance either because of underlying conditions or the lack of a suitable The Fund arrangement.

It is therefore right to consider the question of new channels to provide Fund resources. But we must be aware that a very thin dividing line exists between the risk of postponing effective recovery through inadequate catalytic support and the possible undermining of the Fund's obligations to act commensurate with its responsibilities as a monetary institution by lending unwisely. We would be doing no favors to anyone if we departed from our principle of effective conditionality for disbursement of resources. And, if the capacity to implement appropriate policies has been lost--a defining aspect of post-conflict cases--it is difficult to see how a truly effective assurance of compliance can be provided.

This does not mean however that we are doomed to inaction. We are seeing, for instance in the case of Rwanda, a sensible proposal from the staff to use the existing provisions of the CCFF to provide Fund resources. My guess is that the CCFF will continue to have more applicability elsewhere than the staff paper allows for. And the suggestions in the staff paper for extended use of the policy on emergency assistance seems to offer both a possibility of quick support and some reasonable assurance that future cooperation will ensure that Fund resources will be properly utilized in the context of appropriate economic policies.

We do, however, need to be very sure before we agree to such an expansion of emergency assistance that we have put in as many safeguards as we can. I would be extremely reluctant to see access ever be larger than the proposed use of a single credit tranche. As suggested, this should also be disbursed through small purchases to allow some sort of conditionality. I see it, in many respects, just as one component of other Fund assistance--directly through technical support or through the establishment, as recommended, of mini-PFPs. Fund involvement should also be continuous and directed toward Fund programs with upper credit tranche conditionality. We want our assistance to promote an early graduation to a full program.

This also bears upon the question of interest payments or charges. I do not see the case for trying to establish a formal mechanism for interest subsidies. The answer, for those countries which are considered to be ESAF-eligible--and, of course, there may be some doubt about this after extensive conflicts--is to repurchase the non-concessional finance as soon as possible through use of ESAF borrowing. This might involve reformulating the usual presumption that early repayments would themselves imply non-eligibility for ESAF or other Fund resources.

If we can agree to the staff proposals, we would have two mechanisms available to us in addition to upper credit tranche facilities: the CCFF and Emergency Assistance. Neither of these would however help countries in protracted arrears to the Fund. I see no way that we can avoid this gap except to make the obvious comment that the Fund needs to make it as easy as possible in administrative terms for arrears to be cleared and obviously to provide good information on access to those donors who might be in a position to help clear them.

In conclusion, I can support the proposal for expanding the use of Emergency Assistance subject to the conditions and qualifications outlined in the staff paper and the assurance that access will be limited to a single credit tranche. I welcome the proposals for additional documentation and particularly the idea of a mini-PFP.

Mr. Saito made the following statement:

I would like to commend the staff for the concise and useful paper prepared for today's discussion on Fund involvement in countries experiencing special needs and problems derived from political turmoil, civil unrest, or international armed conflict. I welcome the fact, as noted in the staff paper, that the Fund has always been involved in supporting post-conflict countries as part of an internationally coordinated effort in order to encourage other agencies and donors to provide their assistance within a common macroeconomic framework.

I believe that action taken to assist post-conflict countries depend on the countries' circumstances, their needs and the participation of other international institutions and donor countries. Therefore Fund involvement cannot be uniform, but tailored to each particular case. Similarly, I favor an early involvement of the Fund in providing technical assistance which could facilitate a quicker and smoother transit from the emergency to the rehabilitation phase.

Regarding the Fund's financial assistance to post-conflict countries that require urgent balance of payments support, I agree with the proposal to broaden the current scope of the present emergency assistance policy and with the general characteristics justifying consideration of emergency assistance in post-conflict countries. I agree with the staff that the Fund's financial assistance, under the emergency assistance policy, should be relatively small and available only in the context of a coordinated international effort. In this connection, the Fund's financial assistance should take into account its catalytic role to facilitate the rehabilitation phase of a crisis and, as importantly, to secure an effective additionality from donor countries.

Regarding the suggestion made in the paper in relation to the timing and conditionality of emergency assistance I find them generally appropriate. In particular, like Mr. Mesaki, I would like to stress the importance of technical assistance, preceding the availability of financial resources to those members without a minimum administrative capacity needed to carry out appropriate policies. Regarding subsidized resources, I agree that it may be desirable in some cases of post-conflict countries to seek sources of subsidy in conjunction with the use of Fund resources. However, this should be assessed on a case-by-case basis. Moreover, the use of ESAF resources should not entail a departure from structure and objectives of the ESAF. Similarly, for non-ESAF countries, the terms of upper credit tranche and extended arrangement resources are deemed appropriate for financing their reconstruction and structural adjustment effort.

Mr. Kiekens made the following statement:

The staff report on recent experience with post-conflict countries shows that in general the problems of assisting them have been dealt with satisfactorily.

The delivery of technical and financial assistance has proceeded quite smoothly, with the sole exception of El Salvador, where some problems of coordination arose during the initial stage of the assistance effort.

It seems to me evident that the variety shown by the experiences so far with coordinated assistance to different countries reflects the variation in their political situations and the differences in their external political support. It also demonstrates that the flexibility of the approach used until now has favored the success of the assistance efforts.

Consequently, in my opinion, imposing strict and rigid rules risks paralyzing assistance efforts with rules that do not fit individual cases. By the same token, when we fail to centralize the coordination process in a single institution, we risk creating defects in peripheral actions that interfere with the overall coordination scheme, but I do not favor an automatic lead role for the Fund, as Mr. Havrylyshyn said.

It is against this background that I would like to spell out some general rules for the Fund's intervention in these countries. First, of course, the Fund's economic and financial assistance cannot begin until the political situation is fully settled. Once it has been settled, modest financial assistance from the Fund can play a useful role in catalyzing balance of payments support from the international community in an appropriate macroeconomic framework. Second, we share the staff's skepticism about modifying the ESAF to deal with post-conflict countries. The ESAF is an instrument specifically created to respond to an entirely different class of problems. After a long period of disruption, a country may not immediately be in a position to design and implement an ESAF-type program. For this reason, it might be indicated to amend the Board's decision on emergency assistance might be indicated to cover, more explicitly, these kinds of circumstances. However, I feel that such an amendment should not imply that the Fund's involvement in post-conflict countries should be changed substantially from what it has been doing so far.

The staff's four criteria for defining a post-conflict situation are valid, but incomplete. I would like to add another criterion, namely that it must be reasonably certain that the conflict has indeed been settled with no serious threat of reviving. Involving the Fund prematurely would expose the resources involved to unacceptable risks.

Obtaining a commitment from the authorities to move as soon as possible to a regular Fund program is a necessary additional condition. Flexibility is, however, one of the keys to making this type of support effective. I therefore have no problem agreeing that each of the Fund's interventions should be tailored to the individual circumstances and that all options should be explored to devise the best possible support package for each country.

There is, however, one principle that unquestionably must be observed in all cases--namely, the need to coordinate the Fund's efforts with those of other donors and institutions. I therefore agree that a short document similar to a policy framework paper should be prepared whenever the Fund or the World Bank takes the lead in arranging international financial support in post-conflict cases. Absent a leadership role for the Fund or Bank, the need for such documentation is less, although arguably it would establish a good basis for the transition to an eventual regular Fund program.

Mr. Duenwald made the following statement:

The recent increase in civil unrest and armed conflict around the world strongly suggests that an analysis of Fund involvement in post-conflict countries is called for. Indeed, at their summit last June, the G-7 leaders called for "the Bretton Woods institutions and the United Nations to establish a new coordination procedure, supported as necessary by existing resources, to facilitate a smooth transition from the emergency to the rehabilitation phase of a crisis, and to cooperate more effectively with donor countries." This paper makes a constructive contribution in terms of getting this debate off the ground.

I find the staff's analysis thorough and its assessment of the potential to enhance Fund involvement in post-conflict countries reasonable. However, I feel that a little more detail could have been provided on suggested guidelines to establish at what point a country has reached the post-conflict stage. Under certain circumstances, a situation that was deemed "post-conflict" may in fact represent a temporary reprieve from further chaos. Presumably, a key element of such guidelines would be the return of political stability.

With respect to the coordination of assistance, the paper is helpful in illustrating the importance of flexibility in responding to post-conflict situations. I agree with the conclusion that no single institutional formula seems necessary or appropriate in all cases, and that the best configuration of institutional and bilateral support should be determined on a case-by-case basis. At the same time, it is important that the lead be taken by one institution or donor. It is also important that efforts in support of post-conflict stabilization be made within a common policy framework if assistance is to be most effective.

In the case of post-conflict situations, the Fund can make its greatest contribution through the provision of technical assistance and policy advice. The value of these efforts is catalytic in that the emergence of a sound macroeconomic policy framework and economic stabilization opens the door for greater and more effective assistance from other multilateral institutions and bilateral donors.

With respect to Fund provision of financial assistance to post-conflict countries, the Fund has up to now delayed providing financial resources until the political situation has become clearer and the member has developed a capacity to formulate and implement an economic program. In the five cases outlined in the paper, the Fund was able to provide financial assistance through existing instruments, and, in two cases, assistance was available under the STF (which is no longer available). In terms of the adequacy of existing arrangements and facilities, the staff has identified a number of gaps in the provision of Fund support in post-conflict situations. I agree that a broadening of the scope of the policy on emergency assistance to include post-conflict situations would address these gaps. It is unlikely that this would result in the availability of large scale Fund resources, but it represents a reasonable contribution by the Fund, in that it can be expected to elicit a response from other donors, which is consistent with the Fund's catalytic role. Let me reiterate, however, that at the same time as the scope of access to emergency assistance is broadened, appropriate parameters for such enlarged access must be put in place in order to safeguard Fund resources. This is critical given the fragility and limited capacity to repay of most post-conflict countries.

I also agree that initial recourse to ESAF resources would not be appropriate in post-conflict situations, although ESAF resources might replace initial arrangements, if the country is ESAF-eligible, and after the standard requirements for an ESAF program have been met. To the extent possible, concessionalization of resources provided as emergency assistance, if necessary, should arise from bilateral contributions or from other multilateral institutions. This is necessary not only to preserve the financial position of the Fund, but also to ensure that the quantity of resources available to the poorest countries under ESAF are not compromised.

In conclusion, I believe the staff paper is a constructive first step in delineating the role of the Fund in providing assistance to post-conflict countries. I would add, however, that devising a clearer coordination procedure among the multilateral institutions will be a critical element in this effort.

Mr. Waterman made the following statement:

I do not bring much experience or background to this particular subject, so I will be brief. I have some sympathy for the views that have been expressed by Mr. Mesaki, Mr. Bergo, and Mr. Shields. But, in saying that, I am not sure I am agreeing to a completely consistent package. As the paper draws out, it is clear that post-conflict countries have benefited greatly from the involvement of international agencies, and it is generally important to have a single agency taking the lead role. But, like others, I do not believe that you can say in advance which institution should take the lead role in a particular case. That obviously depends very much on the situation, the country concerned, and the history of the relationship between the country and the various international institutions.

It is probably generally agreed that institution building and policy advice are likely to be the most important issues that need to be addressed in the short term. While financial assistance should not be ruled out, I would be somewhat careful on the lending side until the political climate has been settled and the institutional arrangements strengthened to at least enable the consideration of sensible policy reforms. At the same time, some limited Fund lending might be useful, if not essential, at an early stage on occasions. However, it is also very important for the Fund and the other international institutions to encourage broader donor support and to contribute to a framework that encourages private capital inflows, although I recognize that you cannot expect much on the latter front in the short term. Like others, I think that Fund lending should preferably occur when there are reasonably good prospects of moving to an upper credit tranche program within a reasonable period of time.

I believe the most important assistance the Fund can provide in the short term is technical assistance, particularly in the areas of macroeconomic policy and institution building; and coordination of assistance, particularly of a technical kind, is very important, both in terms of the multilateral agencies and also in terms of assistance being provided by individual countries. From this constituency, we have seen the need for that in Indochina, where assistance is being offered by a large number of countries. I think the Fund is playing a useful role in coordinating those efforts in its area of expertise.

Clearly, assistance will be much more effective if the country concerned sorts out its priorities. Therefore, I support the idea of the member country being encouraged and assisted in setting out its immediate policy objectives in a paper like a policy framework paper involving the key international organizations, including the Fund, the Bank, and others.

Mr. Al-Tuwaijri made the following statement:

The staff has prepared a useful paper outlining the Fund's experience in post-conflict countries. The picture that emerged from the staff presentation is that the Fund's track record in providing assistance to countries emerging from conflict situations has been good. Indeed, the Fund has been engaged at a very early stage through the provision of technical assistance as well as financial assistance when circumstances permitted.

A critical element in the international community's effort to provide technical assistance in post-conflict cases has been the process of coordination between the various interested parties. Differing circumstances between countries, of course, necessitate different approaches to each situation. I therefore agree with the staff that "no single institutional formula seems necessary or appropriate to all cases, but it is important that the lead be taken by one institution or donor."

A continuation of Fund assistance along the lines pursued in the past will be most useful in assisting countries emerging from conflict. The main question raised in the paper is whether the Fund should do more in this area through the expansion of the scope of emergency assistance. To my mind, however, the staff has yet to make a full convincing case in favor of such an expansion.

Indeed, after reading the first section of the papers, I was under the impression that the conclusion would be that Fund policies continue to be appropriate and no changes are warranted.

That being said, I welcome the proposal to enhance the Fund's capacity to assist countries emerging from conflict. However, based on the paper before us, I feel a number of issues need to be clarified further.

First, any proposals in this area must pay due regard to safeguarding the institution's financial integrity and take full account of resources that could become available from other sources. Second, the Fund can provide financial assistance to post-conflict countries through a first credit tranche purchase or a CCFF. In the circumstances, we need to consider further the shortcomings of the provision of Fund financing under current procedures.

Third, the staff notes that in some cases financing from GRA resources needs to be supplemented by donor support to provide subsidies to assist these countries in meeting their debt-service obligation to the Fund. If we decide to expand the scope of emergency assistance, we might need to help ensure the provision of such subsidies in order to allow these countries to avail themselves of Fund assistance.

Mr. Guzmán-Calafell made the following statement:

The Fund has an important role to play in post-conflict countries. Early technical assistance and policy advise by the Fund is crucial to contribute to ensure that financing made available to them is consistent with a sound macroeconomic framework and, consequently, to foster an efficient use of such resources. In addition, as expressed during the last discussion of this issue at the Board, limited Fund financial involvement in these countries can be of significant help, especially through its catalytic impact on other sources of financing. The importance of an adequate participation of the Fund in post-conflict situations is underlined by the fact that the growing share of aid flows channeled to these countries, and the consequent pressures on these resources, call for an increased efficiency in their use.

I will concentrate my remarks on some of the issues for discussion suggested by the staff.

Let me start with the coordination of assistance. As evidenced by other Directors' comments, this is a relatively straightforward topic. Since the current coordination framework has worked well there is no reason to change it. In addition, it would be rather difficult to a priori define specific criteria to assign the leading role to a particular institution in dealing with post-conflict situations. It is also evident that the early preparation of a framework for organizing technical and financial support would contribute significantly to the coordination process.

With respect to the provision of Fund financial resources to post-conflict countries, we agree that expanding the scope of the current emergency assistance policy represents an adequate course of action. We are also in broad agreement with the staff's proposals concerning the operational issues that would need to be considered in case the decision is taken to modify existing policies on emergency assistance. Nevertheless, I would like to make a few observations.

First, the paper proposes that countries experiencing economic or political disruption but having a relatively intact administrative capacity would not qualify for this type of assistance. We have some doubts in this respect, given the fact that adequate timing is normally crucial in emergency situations, irrespective of the situation of the country's administrative capacity, and experience shows that typical Fund arrangements usually take time to be completed. In fact, as explained in the staff paper, in the absence of emergency assistance for post-conflict countries at the Fund, the World Bank initiated financial support to most of the cases reviewed in the paper up to half a year in advance of the Fund. We would of course agree that whenever timing is not a central issue, or when financial support under a traditional arrangement can be provided as expeditiously as under the emergency assistance, Fund support under an arrangement with these countries is the approach to be followed.

Second, the definition of an adequate level of access is not an easy task, considering the need to reconcile the financial requirements of the country, on the one hand, and much higher than usual risks for the Fund, on the other. We agree that access for post-conflict countries will have to be small, made available only in the context of a coordinated international effort, and subject to an assessment of capacity to pay. However, the advantages of spreading out purchases, as proposed by the staff and other speakers, are not clear, since this would reduce an already modest amount of financial support. There is clearly a trade-off between the spreading out of access and the usefulness of Fund's financial support. The possibility of assessing performance under a member's program as an argument in favor of spreading out of access is not very convincing either, since we are dealing with countries where the capacity to develop and implement comprehensive programs of economic adjustment is non-existent. On the other hand, we agree that as in the case of the existing policy on emergency assistance, access for post-conflict countries could be increased beyond one credit tranche in exceptional cases.

Third, with respect to the use of emergency assistance in post-conflict situations by countries that may be ESAF-eligible, the search for donor-financed interest subsidies on a case by case basis in conjunction with the use of the Fund's general resources, as in the case of Rwanda, is a reasonable option. Although the feasibility of actually getting these subsidies is far from certain, we believe this is an alternative that should be pursued.

In closing, I just want to note that Fund's involvement in the early provision of financial assistance to post-conflict countries, while important, can hardly be expected to play a leading role. Clearly, the main task of the Fund in post-conflict situations will not normally be linked to its share in the financial resources granted, but rather to its contribution to the design of a sound macroeconomic framework and the coordination of technical assistance activities for these countries.

Mr. Calderón made the following statement:

We believe that it is important for the Fund to provide swift technical and financial assistance to post-conflict countries.

On technical matters, previous experiences show that the Fund has provided timely technical assistance and policy advice. The issue here is whether this contribution could be improved by implementing a more uniform institutional approach or if the institutional flexibility which has prevailed remains appropriate. I believe that something in between is warranted: flexibility should be maintained but it is important that an explicit lead be taken by one institution or donor. That is, this lead must be recognized by the other institutions involved. This would help avoid problems such as the ones which arose in El Salvador.

With respect to financial assistance, the question is if we need a more rapid mechanism. By definition, the Fund's short-term financial assistance should be provided before or at the same time as the World Bank's more long-term funds. This was not the case in three of the five cases analyzed in the paper.

Hence, we agree with the paper's proposal to expand the scope of the present emergency assistance policy to facilitate Fund financial support to post-conflict countries.

Obviously, such financial assistance should be subject to the operational issues which are well defined in the paper. I will end my statement with some comments on these operational issues:

We agree with the general characteristics described in the paper, as justifying considerations of emergency assistance.

Access should be limited, as a relatively strict rule, up to one credit tranche.

Conditions should include an express intent to move as quickly as possible to an upper credit tranche stand-by, EFF, or ESAF arrangement.

With respect to ESAF-eligible cases we believe that more emphasis should be placed on early replacement of emergency assistance with ESAF resources, than on seeking subsidies on a case-by-case basis.

Mr. Barro Chambrier made the following statement:

Before addressing the issues for discussion, let me make briefly some general observations. First, it is clear that the Fund can play an active role in the early stage of the post-conflicts situations, especially in rebuilding the countries' statistical and policy-making capacity. As has been shown in the past, this can be made possible, particularly through technical assistance and policy advice, and in close collaboration with different multilateral agencies and bilateral donors.

Second, there is no doubt that in the immediate aftermath of a conflict, early involvement from the international community is essential to establish a viable macroeconomic framework and to rebuild administrative and institutional capacity to enable a comprehensive program to be put in place in the countries emerging from conflicts.

Third, regarding post-conflict cases considered in the paper, given the country-specific circumstances, I believe that further elaborations will be needed in the definition proposed, so as to make it more operational, for example when determining use of Fund resources. in this connection, the identification of other specific cases presenting potential conflict risks could be envisaged. The definition provided by other institutions could also be considered.

Turning now to the issues for consideration as proposed by the staff.

First, on coordination of assistance, we share the staff view that in all post-conflict cases, the Fund's involvement has to be part of an internationally coordinated effort. We support the flexible approach that has prevailed to date and do not see the need for a uniform institutional method.

To this end, it is important as shown by the experience in the cases reviewed that the lead be taken by one institution or donor. While the areas of expertise and interest of bilateral and multilateral donors and creditors can differ, and taking into account the country-specific circumstances prevailing, we believe that the coordination of external and technical and financial assistance by a single institution may not be suitable to all cases, as revealed in the study. We note in the staff report that the Fund has helped to encourage other agencies and donors to provide their assistance within a common policy framework. To deliver assistance to post-conflict countries in a more coordinated manner, I can endorse the view expressed by the staff regarding the preparation of a short document similar to a policy framework paper and with a shorter time horizon.

Second, on Fund financial support, it is clear from the cases reviewed that the Fund's role is critical to help a post-conflict country resume its economic activities. This country could benefit from Fund resources, including ESAF resources. However, we are of the view that the major conditionalities of ESAF should be preserved. If it is difficult for the post-conflict country to meet all ESAF conditionalities, more participation could be sought from other aid providers.

On the establishment of an emergency assistance in post-conflict cases, we remain open to this approach. In that spirit, we would like to encourage the staff to provide further elaborations to the issue, that would take into account the remarks already made by previous speakers. But, we would also like to add that if there is obviously a need to improve assistance coordination among aid providers, a rapid response to the post-conflict situations is crucial.

Mr. Cailleteau made the following statement:

My comments will be of a preliminary character, for one obvious reason. The central issue, in my view, is to reach an agreement between the UN, the World Bank and the Fund on a simple and effective coordinated approach. I welcome the rapid reaction of the Fund staff to concerns expressed by some Fund members; but we need to know what are the views of the two other institutions before judging whether the proposed role for the Fund is relevant.

First, we must strengthen our cooperative framework. The report may indeed have downplayed some difficulties faced here or there, although I agree that we should not exaggerate. I therefore believe that more attention could have been devoted, in the context of a common reflection with the World Bank and the UN, to set out a kind of "code of conduct" in case of emergency: in this plan of intervention, the Fund and the World Bank, in particular, would indicate the general characteristics of a framework for their respective economic and financial emergency assistance.

One issue which deserves special attention is the appropriate sequencing of World Bank and Fund emergency financing.

For instance, I wonder whether we should not consider, for these exceptional cases, some exception to our general rule--which I fully support--requesting that a Fund agreement be a precondition to the extension of World Bank of IDA balance of payment support.

Exceptions already exist. A limited exception is the case of Haiti: IDA extended an emergency credit three months before the conclusion of a stand-by.

A substantial exception is the case of West Bank and Gaza. A World Bank Trust Fund has already been operating for more than 18 months.

We should therefore discuss what sort of IMF technical assistance and monitoring arrangement are needed for the World Bank to be able to provide emergency financing, before the conclusion of a Fund agreement.

Second, how best can we tailor our financial assistance? Any Fund financing should remain consistent with our principles: the need for those countries to receive substantial assistance cannot lead us to depart from our prudential rules and our access policy; the need to provide subsidized assistance cannot lead us to misappropriate the use of ESAF finances, which, as reminded by the staff and Mr. Mesaki, are not available for that kind of purpose.

Therefore, we agree that the best avenue is to work under the present policy of emergency assistance, (and here we still endorse the conclusions of 1982), to be cautious as far as access is concerned (given that we cannot use Fund resources for "*reconstruction and development*" *purposes*) *and to be ready* to help the country to seek subsidies to reduce the cost of borrowing.

Mr. Lanciotti made the following statement:

Even though the format and formality of coordination among multilateral agencies and bilateral donors involved in emergency assistance have varied owing to country-specific circumstances, past experience supports the conclusion that strong leadership by one is essential for the effectiveness of the initial assistance effort. Concerning the institutional framework for coordination, I am in favor of maintaining flexibility as concerns the assumption of leadership.

While the Fund, under the present policy framework, can provide technical assistance and policy advice at an early stage, the same does not apply to the provision of financial assistance, where eligibility criteria of the limited available instruments could constitute a restriction for a strong action at an initial stage. The experience of Fund involvement in the five selected recent cases, where technical assistance and policy advice were provided at an earlier stage, compared with financial assistance, seems to give some confirmation of this fact. Even though, the relatively earlier financial assistance in these selected cases (within one half to one year after the end of the conflict) was made possible by specific circumstances of the countries involved, this would not apply for the generality of potential post-conflict cases, under the present policy conditions.

The fact that earlier Fund financial involvement in post-conflict countries can help speed up the stabilization process provides sufficient grounds for the staff's initiative of exploring possible modifications to the Fund's policy on emergency assistance to support post-conflict countries. However, the expansion of the scope of the present emergency assistance policy, in order to include Post-Conflict countries, where appropriate, and under conditions that would adequately safeguard Fund resources, should be considered.

I agree with Mr. Mesaki that the Fund must be cautious about increasing the exceptions to it's basic role of providing short-term Balance of Payments assistance with strict conditionalities. However, this consideration is taken into account by the definition of general characteristics of post-conflict countries to justify the consideration of emergency assistance (mentioned in pages 14-15 of the staff paper), mainly establishing as conditions: the urgent balance of payment need; impossibility of developing a comprehensive program, but sufficient capacity for planning and policy implementation; and concerted international effort underway.

Concerning the staff's proposal regarding interest subsidies for ESAF-eligible countries, I agree with Mr. Mesaki that such a scheme would be inappropriate given the fact that it would involve the use of GRA resources with very week conditionality.

Mr. Berrihun made the following statement:

The Fund has, in recent years, increasingly participated in international efforts to help countries emerging from years of devastation caused by civil wars and social unrest. In this regard, we note that in the five cases reviewed by the staff, the Fund provided valuable assistance in the early stages of these countries' reconstruction efforts in the form of technical assistance, policy advice and financial support. This involvement has also helped to encourage other agencies and donors to provide their assistance within a common macroeconomic framework. It is essential that the Fund should continue to be sensitive and responsive to the hardships of such members, preferably by strengthening and widening the scope of its involvement.

As the staff has rightly indicated, in future post-conflict situations early Fund involvement will be desirable to provide a strong boost to the stabilization effort and catalyze support from others. In view of the urgent need to rebuild institutions and technical capacity in such situations, the Fund will have to be able to provide the requisite technical assistance and policy advice in areas of its competence. Therefore, the timing and adequacy of such assistance are of critical importance, as lack of administrative and institutional capacity not only inhibits the effectiveness of the overall international assistance, but also limits the efforts to put in place a comprehensive economic program in the subsequent phase.

In addition to an urgent need for technical assistance, as witnessed in similar situations in the past, future post-crisis cases are likely to have an immediate need for balance of payments financing from the Fund. So far, Fund's financial assistance has been guided by the existing policy on emergency assistance involving the use of its general resources. As such financing has been limited to the first credit tranche outright purchases, not involving the conditionality associated with arrangements in the upper credit tranches, Fund support has generally been relatively early and, as such, has helped to speed up the process of rehabilitation and start the task of a wide-ranging macroeconomic and structural reform. Because of the urgency of the need for financial support, particularly in the early stages of economic reconstruction, the continuation of the policy of outright purchase would be necessary.

Although the existing policy on emergency assistance has helped to facilitate an early provision of Fund support, it appears not fully adequate to meet the needs of all post-crisis cases as such assistance is normally on a modest scale and is limited to one credit tranche. In this regard, I support the broadening of the scope of the policy to redress these limitations and also include post-conflict situations. The revised and expanded policy should, above all, ensure a level of access that is much higher than at present. This is justified in view of the immense need for foreign financing at the early stage to meet the much required import bill, including essential current payments.

Obviously, there could be risks of Fund exposure in advancing credit to such countries at an early stage of reconstruction. One way out of such a predicament could be some spreading out of access in the form of a series of small outright purchases as suggested by the staff. However, such pattern of financing may not be in the interest of recipient countries which are likely to be under pressure to bring the human suffering to an end as early as possible and make a good start of the rebuilding process. Therefore, it would be highly desirable, if possible, to allow such countries to make repurchases or repayments over a period reasonably longer than the current 3 1/4 - 5 years, perhaps as long as that under the ESAF. Such an elongated repayment period would reduce the risk for the Fund as it would enable the countries to have a firm hold of the rebuilding process--a key factor in improving their capacity to repay the Fund. Moreover, there is an apparent need to make the cost of purchases, particularly for ESAF-eligible cases, as concessional as possible through the use of interest subsidies as suggested by the staff.

While the expansion of the scope of Fund's involvement is necessary, it will be desirable to seek ways of making it more effective. In this regard, it is important to ensure that Fund technical assistance is well coordinated with that of other agencies and donors. This has the advantage of avoiding duplication of efforts and the sometimes conflicting advice, while ensuring that adequate assistance is available at the required time. I would, therefore, fully support the staff's suggestion to improve and strengthen the coordination of assistance.

Mr. Esdar made the following statement:

At this stage I will do my best to summarize our position briefly. We very much welcome the cautious and valuable staff paper on possible Fund involvement in post-conflict countries. Early Fund involvement in post-conflict cases may have a high marginal rate of return for the country in question. However, we have an obligation to ensure that the Fund gets involved in a way that corresponds with its monetary character. Our position can be summarized as follows:

We could support an expansion of the scope of the present emergency assistance policy to facilitate Fund technical and financial support for post-conflict cases, where appropriate, and under conditions that would adequately safeguard Fund resources. We could not, however, support a new facility for this purpose.

Technical assistance by the Fund, in close coordination with other international organizations, has a very important role to play in post-conflict cases, owing to the revolving nature of the Fund's resources. Therefore, the necessary repayment within the short- to medium-term of financial support has to match the limited repayment capacities of the member in question.

The experience met so far with post-conflict cases shows convincingly that leadership of a single institution is desirable. The extraordinary nature of post-conflict cases, however, argues against an inflexible set of preset rules of who should take the leadership, when, and with which coordination mechanism. In the past, this has been decided on an ad hoc basis; however, we would suggest that the institutions involved should further cooperate with the objective of improving existing procedures. In this regard, I do not see much room for improvement for the Fund, but perhaps some further room for improvement in the case of other institutions--for example, the United Nations.

Generally, however, the Fund should not strive for leadership, as the emphasis in post-conflict cases tends to rely on structural and development issues. We strongly support the staff's cautious stance on the level of access in the disbursement schedule. In addition, if subsidies should be sought on a case-by-case basis, they must be made available bilaterally directly to the member in question and not funneled through the Fund resources. This is necessary to prevent extremely problematic situations.

The proposed early repurchase of resources made available under emergency assistance and their replacement with disbursement under subsequent ESAF or extended arrangements should be handled very cautiously to avoid a watering-down of Fund conditionality for these countries. Finally, considering the limited availability of ESAF resources, we could not agree to a waiver for the per capita income criterion to make funds available to post-conflict countries that would normally not be eligible.

Mr. Mohammed remarked that he associated himself with the views of Mr. Al-Tuwaijri with respect to Fund involvement, including financial support, in post-conflict cases.

Mr. Daïri made the following statement:

We welcome the discussion of the Fund's role in countries facing political difficulties and internal and external security problems. The paper before us explains recent experiences in dealing with post-conflict situations that have brought together in a useful way various contributors, including the Bretton Woods institutions and even nongovernmental organizations. Lessons drawn from these experiences are helpful in the effort to consolidate the encouraging gains thus far, as well as to reinforce the Fund's critical role in post-conflict cases.

Indeed, designing a sound macroeconomic framework at an early stage, including rehabilitation and relief, technical assistance, policy advice, and financing, is vital for the countries' revival. Active participation of all possible contributors under a strong leadership is essential for bringing in technical and financial assistance in a timely and coordinated manner. In this regard, better linkages between bilateral and multilateral institutions should be built up for more efficient international interventions in countries ravaged by conflicts, especially since some of these countries seem to have been ignored by the international community. We also noted that early Fund support was critical to secure a successful outcome to economic programs established in post-conflict situations. Indeed, as stated by the staff, technical assistance at an early stage helps the country to rebuild administrative and institutional capacity. Furthermore, timely financing allows the country to build up reserves necessary for financing essential current payments in the context of a coordinated financing package.

Turning now to specific issues for discussion, on the question of institutionalizing the leadership in coordinating assistance to these countries, we believe that flexibility is the best approach, given the number and the diversity of organizations providing international assistance. A strong leadership in coordination has proved to be useful in recent experience, and has been successfully performed by various institutions or bilateral donors. It is vital that general rules providing guidance and organizing actions, including adequate communication, should be set in an agreed upon framework designed by UN agencies and the Bretton Woods institutions, in cooperation with the other concerned organizations. Better coordination and adequate timing of technical and financial assistance, as well as efficient communication, have made a difference in most cases. As stated by the staff, lack of coordination hinders program implementation, as shown in the case of El Salvador in the initial stage.

Concerning Fund financial support, as noted by the staff, the existing instruments are not adequate for all post-conflict situations. Therefore, the Fund should adapt its facilities to conditions prevailing in countries facing such situations, while paying due attention to the need for adequate safeguards of the use of its resources. In this regard, we support the staff's proposal for expanding the scope of the present policy on emergency assistance to include such situations. In our view, conflicts and civil unrest are the most severe disasters that could strike any country. Given the exceptional circumstances prevailing in post-conflict countries, normal procedures regarding access and timing, as well as conditionality, will be difficult to apply. The level of financing should be limited, as a general rule, to the proposed single credit tranche, and financing should be tranched into small purchases based on performance criteria, as was in the case of Russia.

Furthermore, donor support should be sought to provide ESAF-eligible countries with subsidies to reduce borrowing costs. With regard to the preparation of a document containing all elements related to technical and financial support, we agree on its usefulness. However, it should be concise and within a short-term horizon, as indicated by Mr. Barro Chambrier, while specifying immediate policy objectives, problems to be addressed, technical and financial assistance needs and their potential sources.

Mr. Mozhin made the following statement:

Let me begin by saying that I welcome this Board discussion, as it is important, in my opinion, to explore the opportunities for invigorating Fund involvement in post-conflict countries. I am sure that we all want to make every effort to help shorten the transition period from chaos to post-chaos in such countries. In that respect, the attention paid to the issue of coordination of assistance, to countries affected by all sorts of crises, by international fora, including the UN, the OECD, and the G-7, is fully justified.

However, having said that, I must submit that I am not convinced that the Fund is capable of doing much more in post-conflict countries than it has been doing so far without seriously undermining the existing division of responsibilities between various international institutions and agencies. In particular, I do not think the Fund should attempt to compete with international aid agencies, such as specialized aid agencies within the UN system, in providing unconditional emergency assistance. I believe it would be quite natural for such agencies to take the lead at the early stages of international efforts to assist post-conflict countries. Of course, the Fund should be prepared to respond promptly by providing technical assistance in its area of expertise.

The experience of Fund involvement in five post-conflict countries described in the staff paper shows that, at least in these five cases, the Fund was able to respond reasonably soon by providing both technical assistance and, at a proper stage, financial assistance. If we decide that financial assistance from the Fund should be provided even faster, it would be quite natural to approach this on the basis of broadening the scope of the policy on emergency assistance, as suggested in the staff paper. However, the important difference between post-natural disaster countries--to which the policy on emergency assistance is currently applied--and post-conflict countries is the exceptional weakness of the institutional and administrative capacity in the latter. For that reason, one can hardly expect post-conflict countries to be able to comply with even minimal conditionality, unless their institutional and administrative capacity is strengthened. As soon as it is strengthened, with the help of technical assistance from the Fund, financial assistance from the Fund could be provided on the basis of the first credit tranche arrangement.

Let me conclude by saying that we remain open to further consideration of this subject.

Mr. Kaeser made the following statement:

The examples of Fund involvement in post-conflict countries given in the staff paper demonstrate that the Fund has been able to provide assistance in various forms, notwithstanding the fact that our institution does not have a specific instrument to support members under such circumstances. In all the cases reviewed, the Fund was active at an early stage and provided technical assistance and policy advice in the areas in which its experience is greatest. In most cases the Fund was also able to provide financial assistance relatively soon after the conflict.

The Fund has played an important role in the joint effort of multilateral institutions and bilateral donors to help countries move from a chaotic emergency situation into a medium-term rehabilitation phase. By helping to re-establish a rudimentary macroeconomic framework and advising the countries in organizing their fiscal and monetary institutions, the Fund has often also provided an initial framework to coordinate the various sources of financial assistance. Since in most post-conflict cases, assistance is provided in the framework of a concerted international effort involving a multitude of actors, coordination among all participants is crucial to ensure effectiveness. We, therefore, welcome the continuing efforts to enhance such a coordination and encourage management to actively participate in such discussions.

As regards the management of the coordination process, we agree it is important that a major donor or an institution takes the lead in each case. Past experience shows that the establishment of the lead function has in most cases taken place in a satisfactory fashion even in the absence of a rigid institutional formula. We, therefore, do not see the need to establish a uniform approach to determine the lead donor or agency.

As regards financial assistance by the Fund in post-conflict countries, we oppose the expansion of the scope of the existing emergency assistance policy. We have great difficulty in seeing how the Fund could support a credible program under the conditions characterizing a post-conflict situation. With a severely impaired administrative capacity, total lack of statistics and a financial situation that precludes any financial assistance that is not on a grant basis, defining an economic program with a reasonable chance of success and sufficient safeguards for Fund resources appears to be virtually impossible. Furthermore, a program under these circumstances will probably not achieve the catalytic effect that is expected from a normal Fund program.

We remain convinced that the role of our institution at the earliest post-conflict stage should be to provide a maximum amount of technical assistance and policy advice, in order to rapidly establish an environment, in which a normal Fund program can be designed. The cases reviewed in the staff paper show that the Fund was able to provide financial assistance in most cases within six months to one year after the end of a conflict. In our view this is a reasonable time frame, and earlier financial assistance should be left to other participants in the international effort.

The Director of the Policy Development and Review Department noted that the suggestions in the staff paper were based on the Fund's experience over the past few years in assisting countries emerging from conflict situations. The Fund, other agencies, and bilateral donors had learned how involvement in the reconstruction of an economy could be most effective. In the case of El Salvador, all the agencies involved agreed as to why the process had not worked well. The UN had been under pressure to conclude a peace agreement rapidly, and a number of measures had been put forward at the time of the negotiations relating to the demobilization of the armed forces. Many of those measures turned out to be fiscally overburdening. All the parties involved--the UN, the United States, and others--agreed that if there had been more sharing of information, particularly an early macroeconomic analysis of the measures agreed, the recovery process in El Salvador would have been more sustainable. Based on their experience in El Salvador and other cases, there was general agreement that early involvement of different agencies and sharing of information between them was crucial for external assistance to be effective. There was also a recognition that the macroeconomic elements of the recovery process were important, and the agency most suited to establish an appropriate macroeconomic framework was the Fund.

The issue of leadership was crucial because it was very important that assistance in the early stages be closely coordinated, the Director continued. The staff was not suggesting that the Fund take the lead role in coordinating assistance, but it considered that there should be flexibility on the issue, as different agencies would be suited to that role depending on the case at hand. In the past, the UN had taken the initiative, and in some cases, the United States had provided leadership. The UN considered that, to the extent that the political dimension was crucial, it would be taking the initiative in most cases, although it did not rule out the possibility of a bilateral donor or another institution taking a lead role. The World Bank and the UN had seen the draft paper and had supported the substantive issues in the paper, particularly the point that there must be flexibility in determining which institution or donor would take the lead role.

The staff considered that in the early stages, the Fund would not be providing financial assistance, but technical assistance would be essential, particularly as the economic infrastructure in many of the countries would have been severely weakened or destroyed during the conflict, the Director remarked. The staff considered that some financial assistance could be provided when it could be expected that the authorities would have the capacity to implement a rudimentary economic program. The goal of providing assistance at that early stage was no different from the purpose of the systemic transformation facility, namely, to pave the way for a comprehensive Fund-supported program.

The staff was proposing an expansion of the emergency assistance policy because the Fund's support to date for post-conflict countries had been provided on an ad hoc basis, the Director noted. Although the CCFF had been appropriate for some countries, including Rwanda, it might not be appropriate in those countries where exports of critical crops had not suffered owing to the crisis. In two of the cases that the staff had described in the paper, the STF had been used, but the STF was no longer an option. The staff was proposing the use of the emergency assistance policy to provide some flexibility in the Fund's response to countries emerging from conflict. The staff was also suggesting that, in those cases where the country was eligible for ESAF resources, it might be appropriate to introduce an element of concessionality under the emergency assistance policy, through contributions from bilateral donors.

The staff did not consider that it would be feasible to provide financing under the emergency assistance policy for countries with protracted arrears to the Fund, the Director of the Policy Development and Review Department stated.

The Chairman made the following summing up:

Directors in their majority endorsed the staff's views on coordination among the various agencies and bilateral donors and creditors involved in assisting countries in post-conflict situations, and endorsed the suggestion to expand the scope of the present guidelines on emergency assistance to include such situations. However, a number of Directors expressed the need for great caution given the limited role the Fund can play in such circumstances.

Directors welcomed the early provision by the Fund of technical assistance and policy advice in its areas of expertise.

In assessing the post-conflict cases reviewed in the paper, they noted that, in general, the Fund had been able to provide financial support at a relatively early stage, bearing in mind the need for adequate safeguards for use of the Fund's resources.

Looking to the future, Directors emphasized the need for the Bretton Woods institutions, the regional development banks, the UN, and bilateral donors and creditors to coordinate closely in supporting countries emerging from conflict situations. They observed that, in the post-conflict cases reviewed, the process of coordination had benefitted from the leadership of a single agency or bilateral partner, and that different agencies or countries had performed this role effectively in the various cases. Directors concurred that the institutional flexibility that has prevailed to date remained appropriate. While it was important that a lead be taken by one institution or donor, most Directors would not expect the Fund to be the lead institution. Directors were in broad agreement that coordination would be facilitated through an early preparation, where possible, by the affected member and the lead agency, in consultation with other relevant agencies and bilateral donors and creditors, of a framework paper for organizing technical assistance and financial support. Such a report could be similar to a policy framework paper, but less comprehensive, and with a shorter time horizon.

Most Directors thought that the Fund's existing financial instruments were adequate to deal with some post-conflict situations, but that they may not be fully suitable, or available, in all cases that could merit Fund financial support. A majority of Directors endorsed the idea of expanding the scope of the present policy on emergency assistance to include carefully defined post-conflict situations. However, a number of other Directors saw no need for new policies in this area. In their view, experience had shown that the Fund was able to provide financial assistance when conditions were appropriate.

Regarding the operational aspects related to the proposed expansion of the scope of emergency assistance, most Directors were disposed to endorse those proposed by the staff in post-conflict situations: where the country's institutional and administrative capacity was disrupted as a result of the conflict, so that the member was not yet able to develop and implement a comprehensive economic program that could be supported by a Fund arrangement, but where there was nonetheless sufficient capacity for planning and policy implementation and a demonstrated commitment on the part of the authorities; where there was an urgent balance of payments need to help rebuild reserves and meet essential external payments and a role for the Fund in catalyzing support from other official sources; and where Fund support would be part of a concerted international effort to address the aftermath of the conflict situation in a comprehensive way.

Directors agreed that access to Fund resources in such cases should generally be limited to one credit tranche, and that the access policy under the existing emergency assistance guidelines provided sufficient flexibility to handle exceptional needs. Directors supported having a tranching of total resources in some instances to help ensure the effective use of Fund resources and provide an incentive to develop a comprehensive economic program. Most Directors agreed that the proposed Fund financial assistance for post-conflict countries be made available only if the member intended to move within a relatively short time frame to an upper credit tranche stand-by or extended arrangement, or to an arrangement under the enhanced structural adjustment facility (ESAF). Indeed, the use of emergency assistance should be framed in such a manner as to pave the way toward the adoption of a program that could be supported by such an arrangement.

For ESAF-eligible members, Directors recognized that concessional resources would be appropriate. For these members, most speakers indicated that they would favor the approach of seeking interest subsidies from bilateral donors on a case-by-case basis when Fund resources were provided under the emergency policy. Others, however, expressed caution about this approach.

Directors agreed that Fund assistance, and its conditionality, should be tailored to individual country circumstances, and should address the need to rebuild the administrative and institutional capacity required to put a comprehensive economic program in place. Accordingly, conditions would include a statement of economic policies; a quantified macroeconomic framework, to the extent possible; and a statement by the authorities of their intention to move as soon as possible to an upper credit tranche stand-by or extended arrangement, or to an ESAF arrangement. Part of the response must be a comprehensive technical assistance program, including institution-building aspects, and provision for its financing.

Overall, this has been a productive discussion of Fund involvement in post-conflict cases in which Directors have agreed on the fundamental--but generally not the leading--role of the Fund, regarding both cooperation with other international agencies and the parameters for Fund financial involvement through an expansion of the scope of the present policy on emergency assistance. While noting the caution expressed by a number of Directors, I would propose that we proceed to expand the scope of the emergency assistance policy on the basis outlined above. This summing up will provide the guidelines for this approach, it being understood that Fund support under an arrangement is the approach to be followed wherever this is possible, while, in the other cases, emergency assistance would be tailored to pave the way in this direction. Except as noted above, the provisions of the existing guidelines on emergency assistance will apply in post-conflict situations.

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/95/81 (9/1/95) and EBM/95/82 (9/6/95).

5. REPUBLIC OF SLOVENIA - ACCEPTANCE OF OBLIGATIONS OF ARTICLE VIII, SECTIONS 2, 3, AND 4

The Fund notes with satisfaction that, with effect from September 1, 1995, Slovenia has accepted the obligations of Article VIII, Sections 2, 3, and 4 of the Article of Agreement. (EBD/95/112, 8/8/95)

Decision No. 11061-(95/82), adopted September 1, 1995

6. EXECUTIVE BOARD TRAVEL

Travel by an Executive Director as set forth in EBAM/95/122, Supplement 1 (9/1/95) and by an Assistant to Executive Director as set forth in EBAM/95/140 (8/30/95) is approved.

APPROVAL: January 13, 1997

REINHARD H. MUNZBERG
Secretary