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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 88/104

10:30 a.m., July 14, 1988

M. Camdessus, Chairman
R. D. Erb, Deputy Managing Director

Executive Directors	Alternate Executive Directors
A. Abdallah	A. G. A. Faria, Temporary
F. Cassell	
Dai Q.	
C. H. Dallara	
	J. Prader
A. Donoso	E. V. Feldman
M. Finaish	M. B. Chatah, Temporary
G. Grosche	
	Khong K. N., Temporary
A. Kafka	J. Hospedales
	W. N. Engert, Temporary
	N. Toé, Temporary
Y. A. Nimatallah	I. A. Al-Assaf
	L. Filardo
J. Ovi	M. Fogelholm
	D. Marcel
G. A. Posthumus	
C. R. Rye	
G. Salehkhou	O. Kabbaj
A. K. Sengupta	L. E. N. Fernando
	S. Yoshikuni
	S. Rebecchini, Temporary

L. Van Houtven, Secretary and Counsellor
M. Primorac, Assistant

Also Present

African Department: A. T. B. Taylor. Asian Department: M. J. Fetherston. European Department: M. Guitián, Deputy Director. Exchange and Trade Relations Department: J. T. Boorman, Deputy Director; H. B. Junz, Deputy Director; P. A. Acquah, D. Burton, S. Kanesa-Thasan, P. Lenain, B. C. Stuart. Fiscal Affairs Department: K. Nashishibi. IMF Institute: O. B. Makalou. Legal Department: F. P. Gianviti, General Counsel; T. M. C. Asser, P. L. Francotte. Middle Eastern Department: B. K. Short. Research Department: J. A. Frenkel, Economic Counsellor and Director; A. D. Crockett, Deputy Director; L. Alexander, D. A. DeRosa, E. Hernández-Catá, N. M. Kaibni, B. E. Rourke. Secretary's Department: J. W. Lang, Jr., Deputy Secretary. Treasurer's Department: F. G. Laske, Treasurer; Y. Ozeki, O. Roncesvalles. Western Hemisphere Department: M. Caiola, Deputy Director. Personal Assistant to the Managing Director: H. G. O. Simpson. Advisors to Executive Directors: A. A. Agah, K.-H. Kleine, P. Péterfalvy, A. Vasudevan, J. E. Zeas. Assistants to Executive Directors: N. Adachi, R. Comotto, E. C. Demaestri, S. K. Fayyad, V. J. Fernández, B. R. Fuleihan, S. Guribye, M. Hepp, C. Y. Legg, V. K. Malhotra, C. Noriega, W. K. Parmena, A. Rieffel, S. Rouai, Shao Z., E. L. Walker.

1. COMPENSATORY AND CONTINGENCY FINANCING FACILITY - MODALITIES

The Executive Directors considered the Chairman's summing up of the discussion on the compensatory and contingency financing facility at Informal Session 88/8 (7/6/88). 1/

Mr. Rye said that he was speaking on behalf of a group of Directors who were concerned about certain aspects of the summing up on the compensatory and contingency financing facility--notably, Section 5. He apologized for initiating yet another Board meeting, but it seemed preferable to sort out concerns immediately than to raise them in the later meeting that would be devoted to scrutinizing the legal language of the Board decision. In practice, it was necessary for the Board to reach a broad consensus before such a decision could be adopted. Various informal discussions over the past few days had suggested that a sufficiently broad consensus on the question of the minimum threshold and associated matters might not, in fact, exist on the current wording of Section 5.

At Informal Session 88/8, a number of Directors had voiced strong concerns about the proposal for nondeductibility, Mr. Rye recalled. The wording of Section 5 did not seem to meet those concerns. First, the proposal was indefensible on the grounds of equity if one compared the highly differential treatment to be accorded, on the one hand, to a country whose circumstances just triggered the threshold, and on the other, to a country whose circumstances just failed to do so. Second, it was wrong in principle to encourage countries to seek programs that had no margin in them at all, which was the practical effect of Section 5 as it currently stood. While he welcomed the staff's efforts to meet his concerns, as embodied in the second half of Section 5, the result was an extremely complicated scheme, with scope for substantial argument about margins, which could create difficulties for staff in the field. The effect of the current draft would be to divert discussions away from their proper focus on policies and toward complex negotiations about assumptions and statistics.

It was necessary to find a simpler, more equitable, and more certain scheme, Mr. Rye continued. If the Board could agree to restore deductibility, that would solve the problems immediately. However, he recognized the concerns of those who considered as high a deductible threshold as 10 percent to be too constricting. He and the Directors for whom he was speaking would be prepared to trade off a lower threshold for deductibility. If that were thought to create other problems, perhaps some alternative could be found.

The simplest solution would be for the Board to agree on a figure that simultaneously met the reservations of those who were concerned about too high a deductible and was high enough to meet the practical concerns of those who wanted a reasonable threshold.

1/ Reproduced in Annex I.

Mr. Grosche recalled that he had expressed a reservation against the changes introduced at the previous meeting in Section 5--in particular, the provision that Fund contingency financing might not be provided for the full amount of the margin that had been specified in the basic program. After more reflection, he found the current formulation simply not workable, and was in full agreement with Mr. Rye. He could not see how the staff and the authorities would deal with that procedure, first, in terms of quantifying the margin to be built into programs, and second, in negotiating whether or not the margin should be deducted when the threshold was surpassed. He was in favor of building security margins into Fund-supported programs; that was the rationale for the threshold in the new facility. However, it would be overly complicated to quantify those margins in order to deduct the margins from total access after a contingency arose. He therefore wholeheartedly supported Mr. Rye in his suggestion that it be assumed, for the purpose of simplification, that at least a small security margin was always built into basic programs, be that through the implementation of prudent policies or by providing for a security margin in the initial financing package. While it was not easy to build in such margins, if the Fund accepted basic programs that were weak, it would have to make up for that deficiency by providing additional Fund money at a later time. As a matter of principle, it had to be assumed that all basic programs provided for at least a minimum margin, which should not be financed by the Fund. As soon as that built-in security margin was exhausted by external events, full contingency financing, coupled with additional adjustment measures, would begin.

On paragraph 7, Mr. Grosche recalled, several Directors had expressed concerns about the weakness of the wording on the need to make repurchases if the data on which external contingency drawings had been based turned out to be wrong. Admittedly, other Directors felt otherwise, but the current language reflected only their views.

On Section 11, in the last sentence of the third paragraph, Mr. Enoch had suggested replacing the words "officially owned" by the word "relevant," Mr. Grosche noted. He thought that that change had been accepted, but it had not been included in the new text.

Mr. Sengupta asked whether Mr. Grosche's suggestion had been that all future Fund programs have a 10 percent margin added when the Fund provided financing on the basis of a gap.

Mr. Grosche said that in negotiating basic programs, the staff and the authorities should always aim for some room for maneuver. On the one hand, policies should be more conservative in order to avoid unforeseen events throwing the program off track. At the same time, the financing package should give some security to the authorities. The basic objective should be such a balance, instead of quantitative goals. As a general rule, it should be assumed that Fund-supported programs were appropriately financed with sufficient margins having been built in. Then, a certain deductibility in connection with contingency financing would be reasonable because the initial program already provided for some deviations. The level of deductibility depended on the views of the Board. In his opinion, 10 percent was appropriate, since the threshold level implied that a country could bear up to 10 percent of quota deviations itself. In order to achieve a consensus, however, he would be ready to accept deductibility of somewhat less than 10 percent.

Mr. Kafka said that the proposals of Mr. Rye and Mr. Grosche would change the essential features of the agreement. Accordingly, the Board should be very careful before accepting those proposals. If any element that was considered essential by some Directors was changed, the entire proposal would be opened to question--something that should not take place at such a late stage in the discussions. With respect to Section 5, perhaps instead of dealing with percentages, a slight change in wording might meet the concerns of Directors.

Mr. Nimatallah proposed a replacement for the current Section 5, which read:

> For an experimental period until the general review of the Facility has been completed, the staff would work with a de minimis threshold of 10 percent of quota, but if necessary, lower or higher thresholds would be considered. It is expected that there will be few such cases. In order to avoid double compensation and to account for symmetry, the matter of deductibility or nondeductibility of the threshold would depend on the existence and extent of specificity of a quantified margin in the basic program, and on whether the adverse deviations take place early or late in the program period. The less clear the quantified margin and the earlier the adverse deviation, the less deductibility; and, of course, the clearer the quantified margin and the later the adverse deviation takes place, the more deductibility. Similarly, the symmetry provisions of the contingency mechanism might not apply until the favorable deviation exceeded a certain portion of the margin.

The threshold had three purposes, Mr. Nimatallah observed--to avoid double compensation; to sustain the margin as long as possible; and to maintain equity. His proposed paragraph referred early on to the need for avoiding double compensation. Then, with respect to the margin, he had proposed the following compromise: if the deviation occurred early in the program and the quantified margin was not clear, deductibility would be less, while if the deviation took place later in the program and the quantified margin was clear, there would be more deductibility. The question of symmetry was referred to in the last sentence of the paragraph. He had also qualified the reference to a de minimis threshold of 10 percent of quota with the words: "if necessary, lower or higher thresholds would be considered," in response to the phrase in the summing up "...but management would have the freedom to propose...."

Mr. Posthumus said that he supported the views of Mr. Rye and Mr. Grosche on Section 5. He preferred the simpler solution of decreasing the threshold and having it fully deductible to Mr. Nimatallah's proposal, which provided insufficient guidelines for implementation.

In addition, he had a problem with phasing, Mr. Posthumus indicated, and was in agreement with Mr. Grosche on that point. Rather than state that the member would "generally be expected to make a prompt repurchase," the stronger wording "is expected" was preferable in that regard. He also had difficulty with symmetry, but since it did not appear that he had much support in the Board on that issue, he would not raise it again.

The Chairman asked whether Mr. Posthumus could accept a threshold of, say, 10 percent, with 5 percent of that threshold being deductible and margins not being examined closely.

Mr. Posthumus said that that option would be a second best solution, but he preferred that the threshold and the deductible percentages be the same.

Mr. Fogelholm said that he could associate himself with the comments of Mr. Grosche, Mr. Posthumus, and Mr. Rye. Mr. Nimatallah's proposal did not solve the problem of evaluation of the margin. He would prefer a simpler, more transparent solution based on the de minimis approach, with part of the threshold being deductible.

Mrs. Filardo said that if the issues of symmetry, the threshold, and phasing were reopened, the entire agreement would be open for debate. The original staff proposal gave the staff flexibility to manage the size of the threshold and the degree of deductibility; Mr. Nimatallah's proposal was along the same lines, with additional clarification.

The Chairman observed that the choice remaining was between the proposal of Mr. Nimatallah--according to which deductibility would be managed; and the approach favored by Mr. Fogelholm--in which an absolute figure would be set for deductibility. Accordingly, he asked Directors to make a choice between those two solutions.

Mr. Sengupta noted that Section 5 made a concession to the concept of deductibility by giving management and the Board some discretion, which Mr. Nimatallah's suggestion spelled out in greater detail. He could go along with Mr. Nimatallah's proposal, but he preferred the simplicity of setting specific percentages. He agreed with Mr. Posthumus that it made more sense to set the deductible and the threshold at the same figure. If that could not be agreed to, then the levels of the threshold and the deductible should be clearly specified. He did not consider that significant margins existed in Fund-supported programs, but if the assumption was that they did, that should be made explicit. Then the Board could state that, say, 5 percent additional margin had to be provided in all programs because contingency financing began above a 5 percent deviation.

Mr. Grosche agreed that the question was whether to develop very tight basic programs, which could easily go off track either because the policies could not be implemented or were too ambitious or because financing was not available. He felt that the basic program had to be flexible and that contingency financing should be provided only for major external contingencies that went beyond a certain threshold. Up to that threshold, the program should remain viable. More financing would be the best solution, but if that was not possible, more conservative, more ambitious policies had to be sought.

Mr. Rye observed that Mr. Nimatallah's proposal opened a number of areas for negotiations between country authorities and the staff and, accordingly, did not meet his concerns. Mr. Sengupta's suggestion to spell out margins also opened up a whole new area of negotiation, which was most undesirable. However, insofar as Mr. Sengupta had made a plea for more flexibility, he could accept the deletion of the words: "in what is expected to be the relatively few cases where this was necessary," which, as it were, prejudged something that the Board might find was not the case in practice. He continued to believe that the simplest solution would be to have a lower threshold that would also be the deductible, because, in principle, the two were indistinguishable. However, he accepted for practical purposes that the threshold would be used as a filter to reduce the number of cases brought to the staff and to the Board. For that reason, he could accept the selection of different figures for the threshold and for the deductible. For example, a 10 percent threshold could be combined with a 5 percent deductible.

The Deputy Director of the Exchange and Trade Relations Department said that the suggestion of Mr. Rye would be simpler to implement than that set out in the proposed summing up, which would require additional negotiations to agree on the margin that had been built into programs. It would be to the authorities' benefit to argue that the program had no margin, thus avoiding deductibility of any threshold. Accordingly, the proposal of Mr. Rye to accept a given threshold with a 50 percent deductible would be more straightforward.

Mr. Dallara asked whether it was more complicated to administer a system in which the threshold differed from the deductible.

The Deputy Director of the Exchange and Trade Relations Department pointed out that the greater the threshold, the fewer the cases that would be brought to the Board. Accordingly, the Fund's work load would be affected significantly by the level of the threshold. If the deductible were to differ from the threshold, the relationship between the two figures would have to be clearly defined in order to avoid yet another negotiable parameter.

Mr. Grosche said that he was willing to accept a 10 percent threshold with a 5 percent deductible. The threshold would avoid the triggering of too many cases, while the lower deductible would lead to a consensus in the Board.

Mr. Sengupta said that he considered the simplest solution would be to have a 5 percent threshold and deductible, with management having the freedom to propose a lower or higher figure.

The Chairman believed that it was preferable not to place that burden on management and staff; accordingly, he would suggest a threshold of 10 percent.

Mr. Sengupta remarked that if the deductible was to differ from the threshold, it should be explained in the summing up that the amount of the deductible was expected to be built into the basic program as a margin.

The Chairman said that while he appreciated the logic of Mr. Sengupta's argument, the Board was seeking to create a text that would avoid a debate on margins. It was therefore preferable not to specify the relationship between the deductible and built-in margins.

Mr. Grosche agreed that there should be no direct link between the deductible and margins, which were difficult to quantify. In any case, he would expect that margins of at least 5 percent were built into programs.

Mr. Kafka pointed out that a 5 percent deductible was not as low as it appeared, since stand-by and extended arrangements generally did not grant access of more than 40 percent of quota. Accordingly, a 5 percent deductible would imply a 12 1/2 percent of quota margin. He was not familiar with any programs that had such high margins.

The Chairman proposed that for the sake of simplicity the threshold be set at 10 percent, and the deductible at 5 percent, for the experimental period. The next question was whether, if the threshold was changed according to the judgment of management, the deductible should remain at 5 percent, or be set at 50 percent of the threshold. He suggested that a 5 percent deductible be used for the experimental period.

Mr. Rye said that he could go along with Mr. Kafka's proposal, as elucidated by the Chairman.

Mr. Posthumus suggested that the words "de minimis" be deleted from the first sentence of Section 5.

Mr. Sengupta proposed that the Chairman make the point in his summing up that the 5 percent deductible would be expected to be built into the basic program as a margin.

The Chairman said that he preferred not to change the parameters of stand-by or extended arrangement negotiations by making a specific reference to the deductible.

Mr. Nimatallah noted that the 5 percent margin was related to the size of the program while the 5 percent deductible was related to quota size.

Mr. Grosche said that the concept of a built-in security margin should be reflected in the summing up. It was not necessary to state that each and every program had to include a 5 percent security margin, but that would be a general rule. He hoped that all programs would in fact have greater than 5 percent margins.

Mr. Dallara remarked that the discussion on margins was partly out of context, and should take place when the design of Fund programs and financing was being considered. On the emerging consensus, he had some hesitation in supporting the 10 percent threshold, 5 percent deductible solution, partly because of Mr. Kafka's point that 5 percent of quota was 12 1/2 percent of an average program size. More important, if a member country had an 18-month program and tried to phase the use of contingency financing over that period, then, during any 12-month period, 5 percent of quota could be as much as 15 or 20 percent of the anticipated use of contingency financing during that period. A case could, therefore, be made for a lower deductible--say, of 3 percent.

Another solution would be to phase the application of the deductibility, Mr. Dallara went on. He was concerned by the notion that the full 5 percent would be deducted up front, because that eliminated a program's margin for the remaining period. Obviously, margins could not be preserved indefinitely or they would not serve their function, but nevertheless a case could be made for not using up the entire margin at the first sign of an external shock. Would other Directors be interested in the possibility of phasing the application of the deductible?

Mr. Yoshikuni said that he fully shared the concerns of Mr. Dallara on the question of the margin. His chair had supported nondeductibility of the threshold precisely because it was difficult to prespecify a reasonable margin.

Mr. Grosche said that his argument differed conceptually from that of Mr. Dallara. In basic programs, certain securities were built in, perhaps by providing a little more financing from the outset or by having cushions in terms of macroeconomic and other policies. If an external shock was greater than allowed for by that built-in security, the margin was eroded and financing was necessary. At the same time, additional adjustment measures had to be imposed to take care of the external shock, and additional margins should be re-established at that time. However, when policies were tightened, it was difficult to reintroduce security margins into the program. The goal was that basic programs could adjust to minor contingencies, with major deviations being covered by contingency financing.

Mr. Donoso pointed out that Mr. Dallara's concern, with which he sympathized, was taken care of by Mr. Nimatallah's proposal. He asked whether Mr. Grosche and Mr. Rye would support 100 percent financing of the remaining part of the deviation if a deductible were prespecified.

The Chairman remarked that the Board was trying to arrive at an absolute figure that would be presumed to cover built-in margins in order to avoid calculating specific margins for each program. A 5 percent deductible had been established as an estimate that would reduce the risk of overcompensation during the experimental period. A more precise evaluation would require reopening the entire debate.

Mr. Donoso said that he supported the views of Mr. Dallara. His point had been that if a threshold was established, it was only consistent to make a similar commitment on the percentage of the deviation beyond that threshold that would be financed.

Mr. Rye said that while he acknowledged the logic behind Mr. Dallara's argument, he agreed with the Chairman that such an approach would greatly complicate the issue. With respect to the calculations of Mr. Dallara and Mr. Kafka on the effective percentage of the deductible, those arguments also applied to the threshold. The Board ought to be seeking a simple, workable rule of thumb that could be applied in the experimental period; he considered that the 10 percent threshold with a 5 percent deductible met those needs.

Mr. Kafka remarked that his first preference remained the Chairman's original formulation. He was not enamored of the 10 percent threshold, 5 percent deductible solution, but it was preferable to a solution in which the threshold was set at a minimum of 5 percent but could be increased indefinitely.

Mr. Cassell commented that Section 5 as it stood in the summing up would be overly complicated to implement. One alternative would be Mr. Nimatallah's solution, which was preferable to the original draft but still left unresolved questions. His first choice, however, would be the proposal of Mr. Rye to set out quantities of a 10 percent threshold and 5 percent deductible. That had the great advantage of cutting the paragraph in half and resulting in a simple solution.

Mr. Kafka observed that some Directors preferred the original formulation, while others preferred the Rye formulation. He considered that the Nimatallah solution would be a reasonable compromise.

Mr. Toé said that he supported Mr. Nimatallah's proposal.

Mr. Dallara asked whether the Nimatallah formulation was actually workable. It contained a number of compromise elements, which he welcomed, but at the same time would complicate the operation of the facility. As he saw it, the proposal of Mr. Nimatallah allowed the deductible figure to vary, while ensuring that there would indeed always be a deductible.

The Deputy Director of the Exchange and Trade Relations Department said that phasing, which was already incorporated under the external contingency mechanism, would account for some of the concerns underlying the drafting of Mr. Nimatallah's proposal. That proposal was feasible but it did add a number of variables and, accordingly, would add to the complexities in the negotiations with the authorities.

The Deputy Director of the Research Department remarked that there was another complexity to Mr. Nimatallah's proposal, which while not insurmountable, ought to be borne in mind. When a program was negotiated and put into effect, an uncertainty would remain as to whether the authorities would face a high or a low deductible; all that could be specified were the parameters that would determine the level of the deductible when the contingency actually arose.

Mr. Nimatallah clarified that there could be cases in which there was no deductibility if a contingency occurred early and if the margin was not clearly defined.

The Chairman asked Directors to specify whether they preferred the proposal of Mr. Nimatallah, that of Mr. Rye, or the original formulation in the Chairman's summing up.

Mr. Sengupta, Mr. Marcel, and Mr. Faria said that their first choice would be Mr. Rye's proposal; the Chairman's summing up was their second choice.

Mr. Dai, Mr. Kafka, Mrs. Filardo, and Mr. Toé said that they supported the Chairman's summing up; their second choice would be Mr. Nimatallah's proposal.

Mr. Prader said that his first solution was that of Mr. Rye, and the second best was Mr. Nimatallah's solution.

Mr. Donoso said that his first preference would be the Chairman's summing up as it stood. He abstained on his second choice.

Mr. Cassell, Mr. Posthumus, Mr. Rye, Mr. Fogelholm, Mr. Chatah, and Mr. Engert said that their first choice would be Mr. Rye's solution. They preferred not to state their second choice at that time.

Mr. Yoshikuni said that his first preference was the Chairman's summing up, but he could go along with the majority as his second choice.

Mr. Grosche said that his first preference would be Mr. Rye's proposal; his second preference was the Chairman's previous summing up, in which it was stated that "...Fund contingency financing would not be provided for the full amount of the margin," rather than "...might not be provided...."

Mr. Khong said that his first preference would be the summing up and that his second choice would be Mr. Rye's proposal.

Mr. Nimatallah and Mr. Rebecchini said that any of the three proposals was acceptable to them.

Mr. Dallara and Mr. Salehkhou said that their only choice was the summing up.

The Secretary indicated that 15 Directors--who held 61.99 percent of the voting power--either preferred or could accept the Rye solution. Of those 15, 11 Directors with 47.04 percent voting power had it as their first choice. Two Directors could live with any of the three solutions and two Directors had it as their second choice. With regard to Mr. Nimatallah's proposal, six Directors accepted it as a second choice and two would support any of the three solutions, for a total of about 29 percent of the voting power. On the Chairman's summing up, nine Directors, holding 44 percent of the voting power had it as their first choice, with another five who could accept it as a second choice or could live with any solution, for a total of 61.84 percent of voting power.

The Chairman concluded that there was a slight preference for Mr. Rye's solution and accordingly suggested that that be the agreed solution until the review of the new facility.

Mr. Sengupta asked the Chairman whether, since the majority difference was so slight, Directors could attempt to achieve a greater consensus through bilateral discussions.

Mr. Dallara remarked that while his preference was the Chairman's summing up, he agreed that given the slight majority, the Rye proposal should be accepted. However, Mr. Rye and his colleagues might wish to acquire a larger consensus. While most issues involving the new facility had had a greater degree of support, discussions could not continue much longer. One solution might be to reduce the 5 percent deductible to 3 percent, for example.

Mrs. Filardo indicated that she could go along with a reduction of the deductible to 3 percent.

Mr. Rye remarked that if Mr. Dallara were willing to go along with his solution, then the majority support became considerably larger. He felt that a 3 percent deductible was altogether too low, but he was in the hands of his colleagues.

Mr. Grosche said that he was also unhappy with a 3 percent deductible.

Mr. Fogelholm said that he could go along with a deductible of 4 percent. He asked what the procedure would now be for discussion of the new facility.

The Chairman suggested that discussion of the contingency and compensatory financing facility could continue on the following day as the first item of the agenda after the 9:00 a.m. meeting on review of country cases.

Mr. Salehkhou recalled that both the Board and the Interim Committee had undertaken a commitment to preserving the essential features of the compensatory financing facility as a condition for the establishment of a new combined facility. That principle had been reiterated in the Chairman's summing up. His chair had repeatedly asked the staff to identify the essential features of the compensatory financing facility and to explain exactly how those features were to be preserved under the new combined facility. Unfortunately, the staff had not yet done so, thus reinforcing his conviction that those features would not survive intact under the new facility. In his view, some of those essential features related to coverage, lower conditionality, relatively high access, and quick and automatic disbursement.

On coverage, Mr. Salehkhou continued, it was obvious that since contingency mechanisms would cover unanticipated changes in export earnings, cereal costs, and import volumes, as well as tourist receipts and migrant workers' remittances, the compensatory financing facility would no longer be a unique Fund facility designed to cover such variables. Moreover, the coverage of exports in both the contingency and compensatory elements appeared designed to lead to the eventual emasculation of the compensatory financing facility. He had already raised that issue at EBM/88/94 (6/17/88), and Mr. Sengupta had elaborated further on it at EBM/88/100 (6/27/88). On those occasions, it had been indicated that as long as a country was under a Fund arrangement, export shortfalls would be treated as a deviation from the program scenario and consequently would be eligible for external contingency financing but not for compensatory financing. In addressing that point, the staff had proposed that a member with a contingency mechanism that included export earnings as a variable should be able to be compensated under both contingency and compensatory financing, provided the amounts financed under one component were deducted from the amounts to be financed under the other. That approach could be acceptable if export shortfall were treated equally under both elements of the contingency and compensatory financing facility. However, that was clearly not the case, since the methods of calculation, the financing available, and the conditionalities attached to the two elements were all quite different.

Under the compensatory element, Mr. Salehkhou observed, an export shortfall was calculated ex post as the amount by which exports in the shortfall year were below the geometric average of exports for a five-year period centered on that year. Under the contingency element, the same export shortfall was calculated ex ante in relation to a baseline projection. Under the compensatory element, financing was constrained only by access limits. Under the contingency element, financing was the aggregate of the deviations of a number of variables moving in opposite directions and was also constrained by access limits, the limit of 70 percent of the associated arrangement, and the limit of a proportion of the deviation.

The fact that export shortfalls were eligible for both contingency and compensatory financing could raise the issue of cross-conditionality between the two elements, Mr. Salehkhou went on, with the country having to satisfy the requirements of both elements if it wished to maximize its flexibility. Cross-conditionality would be particularly relevant when the export shortfall exceeded 65 percent of quota, and when it went beyond 70 percent of the associated arrangement. The limit of 70 percent would be binding for members that had arrangements under the structural adjustment facility or small stand-by arrangements. In such cases, the country could choose to finance such export shortfalls under the compensatory element--subject to the limit of 65 percent of quota. If, on the other hand, the country opted to finance its shortfall under the contingency element, that could be done up to the lower of 65 percent of quota or 70 percent of the associated arrangement. If the shortfall required financing of more than 70 percent of the associated arrangement, the adjustment framework would need to be considered in its entirety, possibly in the form of a new arrangement, according to EBS/88/100.

To avoid such a situation, Mr. Salehkhou suggested, the Fund should specify that when the limit of 70 percent became binding, a member undergoing contingency financing for export earnings, tourist receipts, and workers' remittances should be compensated under the contingency element up to the equivalent of 70 percent of the associated arrangement and under the compensatory element for the remaining 30 percent. The staff ought to prepare operational guidelines on that and other subjects so as to help members exercise their choice between the compensatory and contingency elements.

Finally, the compensatory financing facility had been attractive and helpful because of its relatively high access and quick and automatic disbursement, Mr. Salehkhou noted. Neither of those features were present in the new facility, since access was reduced from 83 percent of quota to a maximum of 65 percent of quota and phasing was increased.

In commenting on the points he had raised, Mr. Salehkhou suggested, the staff might wish to identify other essential features of the compensatory financing facility and explain how such features were preserved under the new facility. In any event, further analysis, perhaps in the form of a study paper, was required to show that the essential features of the compensatory financing facility had indeed been preserved under the compensatory and contingency financing facility. Such evidence should be reflected in the Chairman's final summing up as well as in the relevant decision.

The Deputy Director of the Research Department made the following statement:

Mr. Salehkhou has raised the question: "How have the essential features of the compensatory financing facility been preserved under the new facility?"

The essential features of the compensatory financing facility may be summarized as follows: provision by the Fund of timely assistance to members in balance of payments need to compensate for temporary export shortfalls attributable to factors largely beyond the control of the member, provided that the member is willing to cooperate, where necessary, to find appropriate solutions to its payments problems. In my remarks, I shall focus on how these features have been treated under the proposed compensatory and contingency financing facility.

Under the new facility, the compensatory window provides compensation for export shortfalls in much the same way as the present decision does: the export shortfall must be judged to be temporary, largely beyond the control of the member, and there must be a need for the member to make a purchase; also, there has been no change in the coverage of the compensatory financing facility--that is, the possible inclusion, at the option of the member, of receipts from certain services and outlays for cereal imports as well as export earnings--and the definition of export shortfalls, except for minor refinements, has remained unchanged. The aspects of the compensatory financing facility that have been affected by the new facility are essentially related to access and conditionality; the new facility also has implications for the timeliness of compensatory financing facility assistance.

1. Access and conditionality

I should preface my remarks on access and conditionality by noting that these aspects of the compensatory financing facility have been the subject of previous reviews by the Board, and as a result of these reviews the access limits for compensatory purchases and the conditionality associated with them have been modified from time to time. The present exercise may thus be considered as part of an ongoing examination by the Fund of its policies in light of changing circumstances. It is also relevant to note that, since the Fund's resources are not unlimited, the Fund must attempt to strike a balance not only between the resources that it makes available under its various policies, but also between access and conditionality under each policy.

Turning to the compensatory financing facility provisions under the new facility, there has been no change in the access for members with balance of payments difficulties not extending beyond the effects of the export shortfall. That is, the present limit of 83 percent of quota has been maintained. While compensatory access limits under the new facility have been reduced for other members, these countries may now qualify for Fund financing under the provisions for contingency financing. Thus, the impact of the reduction in compensatory access on use of Fund resources for these countries would be mitigated by the availability of contingency access. This is particularly important in cases where compensatory financing access has been exhausted and the member concerned experiences an export shortfall as well as contingent deviations that could qualify it for use of the new facility. As Directors know, under the new facility, the total access for compensatory and contingency financing of 105 percent of quota would be greater than the current compensatory access of 83 percent of quota.

2. Timeliness of disbursement

The provisions in the proposed decision linking compensatory financing facility disbursement to the developments with respect to adjustment could be considered more as a codification of existing practices than as an innovation. In recent years, most of the compensatory financing facility drawings have in effect been linked to the negotiation of Fund programs. Indeed, under the new facility access to the first tranche for compensatory financing (either 20 percent of quota or 40 percent depending upon the circumstances of members) should become easier, now that the cooperation requirements have been clarified. Whereas in the past a country was likely to have to wait until the program negotiations were completed in order to make a single drawing for maximum access, it should now be possible to obtain part of the access at an earlier stage. I should also add that the early drawing procedure, which is designed to facilitate timely compensation by permitting use of partly estimated data for the shortfall year, has been maintained.

Extending his remarks, the Deputy Director of the Research Department indicated that the staff would prepare a more technical paper in response to Mr. Salehkhou's questions on calculations and on the relationship between access under the two elements for eventualities that might qualify under both elements. Operational guidelines would certainly be prepared. However, when a country had an export shortfall that qualified it for compensation under either element, the new facility would not disadvantage that country as compared with the compensatory financing facility. If a country was compensated only partially under the contingency mechanism for an export shortfall occurring after the inception of a program, that country could obtain compensatory financing for the remainder of the shortfall, thereby receiving the same amount of financing as would have been provided by the compensatory financing facility.

Mr. Kafka suggested, on Section 8, that a country that experienced a favorable shock be allowed to strengthen its external position as it saw fit, and not necessarily by adding to reserves, reducing purchases under the basic arrangement, or repurchasing contingency purchases.

Mr. Grosche indicated that he accepted Mr. Kafka's suggestion.

The Executive Directors agreed to continue their discussion on the following day.

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/88/103 (7/8/88) and EBM/88/104 (7/14/88).

2. STAFF MEMBER - LEAVE WITHOUT PAY

The Executive Board approves the proposal set forth in EBAP/88/164 (7/6/88) concerning an extension of leave without pay for a staff member.

Adopted July 11, 1988

3. APPROVAL OF MINUTES

a. The minutes of Executive Board Meeting 87/154 are approved. (EBD/88/179, 7/1/88)

Adopted July 8, 1988

b. The minutes of Executive Board Meeting 87/155 are approved. (EBD/88/180, 7/5/88)

Adopted July 11, 1988

c. The minutes of Executive Board Meeting 87/156 are approved. (EBD/88/181, 7/6/88)

Adopted July 12, 1988

d. The minutes of Executive Board Meetings 87/157 through 87/160 are approved. (EBD/88/184, 7/7/88)

Adopted July 13, 1988

4. EXECUTIVE BOARD TRAVEL

Travel by Executive Directors as set forth in EBAP/88/167 (7/8/88) and EBAP/88/170 (7/12/88), by Advisors to Executive Directors as set forth in EBAP/88/167 (7/8/88) and EBAP/88/170 (7/12/88), and by Assistants to Executive Directors as set forth in EBAP/88/166 (7/8/88), EBAP/88/167 (7/8/88), and EBAP/88/168 (7/11/88) is approved.

APPROVED: March 2, 1989

LEO VAN HOUTVEN
Secretary

The Chairman's Summing Up of the Discussion on
the Compensatory and Contingency Financing Facility
Informal Sessions 88/7 and 88/8, July 6, 1988

These remarks summarize my understanding of the agreement that has been reached on the general principles and specific modalities for the compensatory and contingency financing facility. My informal remarks of April 7, 1988 (Informal Session 88/5, 4/7/88) on the same subject form an integral part of the understandings and are included as an appendix to this summing up.

At the meetings that took place in March and April of this year, broad agreement was reached on general principles and a framework for the new facility. In particular, it was concluded that the essential features of the compensatory financing facility should be preserved; that contingent Fund financing could help maintain the momentum of adjustment programs against adverse external shocks; and that the basic features of contingency mechanisms should include an appropriate blend of adjustment and financing, incorporate symmetry, and involve external factors beyond the control of authorities, subject to a minimum threshold level for activation. To these principles I would add the need to pursue parallel contingent financing vigorously where necessary and to ensure that programs continue to be adequately financed when Fund resources are disbursed. It is also important to stress that purchases under this facility, as under all Fund facilities, would be subject to balance of payments need and that, in providing financing under this facility, due attention will be paid to the member's capacity to meet its obligations to the Fund.

In our meetings over the past few weeks, Directors have reached agreement on a number of operational modalities for the new facility and the features of this agreement are summarized below. Directors also concluded that in order to avoid creating an unduly rigid and complex system, many detailed operational aspects of contingency financing would have to be developed with the authorities at the time each associated arrangement is framed, on an experimental and case-by-case basis. As each case comes before the Board, and is commented on by Directors, that experience will be duly reflected in subsequent cases. Then, before the 1989 Annual Meeting, there will be a general review of the compensatory and contingency financing facility based on experience with its operations.

I will now turn to the detailed modalities for the new facility.

1. Access limits for contingency mechanisms

Contingent financing would be subject to the cumulative access limits for the facility. In addition, contingent financing would not generally exceed 70 percent of access under the associated arrangement. For multi-year arrangements there would be a flexible approach for distribution of access as between years; normally, some front-loading and carry-over of access would be provided for, but access in any one year would not generally exceed 70 percent of the access available under the associated arrangement in each 12-month period.

2. Activation

Contingency mechanisms would be attached to Fund arrangements and would be approved by the Executive Board at the time of the approval of the associated arrangement. Contingency mechanisms generally would be activated on the basis of a review by the Executive Board. Such reviews would normally be conducted within the context of a midterm program review, although in some cases it might be useful to conduct an ad hoc review. Eventually, some of these reviews might occasionally be conducted on a lapse of time basis, but it is understood that in the early experimental stage of the new facility a discussion by the Executive Board would take place in each case.

In some exceptional cases where the link between additional financing needs and the relevant contingencies and the policy actions that would need to be phased in could be specified in advance with sufficient precision, the Executive Board could give advance approval for the disbursement of contingent financing without further Executive Board review. In such cases, the staff assessment could be expedited and, after the Board has received adequate advance notification, disbursements would be made. All purchases would of course require observance of the arrangement's performance criteria, adjusted by the Executive Board as necessary to take account of the effects of the contingencies.

3. Resources for contingent financing

Purchases for contingent financing will use ordinary resources with a repurchase period of three to five years. Access would be considered separate from holdings resulting from the use of Fund resources under any other policy but not from holdings resulting from purchases on account of export shortfalls or excess cereal costs. As is the case with purchases under tranche policies, purchases for contingent financing and holdings resulting from such purchases would be excluded for the purpose of determining a member's reserve tranche position.

4. Choice of the optional tranche

The optional tranche would be divisible. Prior to activation of a contingency mechanism, members would be free to choose the application of the optional tranche, except when the member requests and the Fund agrees to specify in advance an allocation of the optional tranche; it is expected that this would mainly involve cases where parallel contingent financing was being arranged. At the time of activation of the contingency mechanism, members would commit themselves on the use of the optional tranche for the remaining period of the baseline.

5. Minimum threshold

For an experimental period until the general review of the facility has been completed, the staff would work with a de minimis threshold of 10 percent of quota, but management would have the freedom to propose a lower or higher figure in what is expected to be the relatively few cases where this was necessary. The threshold would not be deducted before calculating the financing to be made available or before applying the symmetry procedures. In order to avoid double compensation, the staff would evaluate the margin being incorporated in Fund-supported programs, and, to the extent that a quantified margin had been specified in the basic program, Fund contingency financing might not be provided for the full amount of the margin. Similarly, the symmetry provisions of the contingency mechanism might not apply until the favorable deviation exceeded a certain portion of the margin.

6. Proportion of deviation to be financed

The proportion of a contingent deviation to be financed would be determined on a case-by-case basis to ensure an appropriate mix of adjustment and financing and would be established at the outset of the arrangement with a contingency mechanism. In the period immediately after an adverse shock has occurred, it would normally be expected that the Fund would finance a substantial proportion of the adverse deviation. Every effort would be made to obtain parallel contingent financing from other creditors and contingency mechanisms would not be activated unless the program continued to be adequately financed. The proportion of the deviation to be financed could be changed at the request of the member at the time of the activation of the contingency mechanism, if the program was being affected by shocks of a nature that made the originally decided split between financing and adjustment inappropriate.

7. Phasing

Contingent financing would be phased through the baseline period at the same time as purchases under the associated arrangement. The phasing would take into account the time path of the net deviation from the baseline and the timing of the implementation of additional policy measures. When a shock covered by the contingency variables had occurred, the first purchase would be made available when the cumulative deviation from the baseline was projected to exceed the threshold. Subsequent purchases would be proportional to the net deviation estimated for the corresponding quarters, on the basis of shocks that had already been observed. When a member has made a purchase under a contingency mechanism on the basis of an estimated deviation which later is shown to be incorrect, the member would generally be expected to make a prompt repurchase to reverse any overcompensation.

8. Symmetry

When a favorable deviation relative to the baseline occurs, a substantial part of the favorable deviation would be used to build up reserves in cases where reserves were low. Where reserves were at a more adequate level, part of the favorable deviation would be reflected in a reduction of purchases under the basic arrangement, or, if an earlier contingency purchase had been made, the member could opt to repurchase contingency purchases.

9. Eligibility of arrangements under the structural and enhanced structural adjustment facilities for contingency mechanisms

It has been agreed that it would be desirable to permit contingency mechanisms to be attached to arrangements under the structural and enhanced structural adjustment facilities. In view of the limited amount of resources available to the Special Disbursement Account and the ESAF Trust and the restrictions on their utilization, financing for this purpose would need to be provided from the Fund's general resources. The possibility of providing for concessionality in the resources disbursed under contingency mechanisms for low-income countries will be reviewed at a later date.

The use of the Fund's general resources for contingency financing for arrangements under the structural and enhanced structural adjustment facilities raises issues with respect to the uniformity of treatment of Fund members. For this fundamental principle to be maintained, the conditionality attached to the use of the Fund's general resources under a contingency mechanism must be the same, whether this is in connection with arrangements under the structural and enhanced structural adjustment facilities, or an upper credit tranche arrangement.

This does not pose difficulties with respect to the enhanced structural adjustment facility, but to enable a contingency mechanism to be activated for an arrangement under the structural adjustment facility, it would be necessary for the member concerned to agree to a program sufficiently strong to permit the Executive Board to determine that the structural adjustment facility arrangement in question entailed conditionality equivalent to that of an upper credit tranche arrangement. It would also, as a practical matter, be necessary for such structural adjustment facility arrangements (and, as relevant, for arrangements under the enhanced structural adjustment facility) to incorporate stronger provisions for monitoring, including a review to change benchmarks as necessary and to formulate them in a way that would govern the phased disbursements under the contingency mechanism, as well as to activate the mechanism.

The principle of uniformity precludes a differentiated overall ceiling on access to the Fund's general resources. Therefore, care will be taken to ensure that a member eligible for arrangements under the structural and enhanced structural adjustment facilities would not, by virtue of its eligibility both for arrangements under those facilities and for upper credit tranche arrangements, have higher access to the Fund's general resources under the contingency mechanism than a member who is not eligible for arrangements under the structural and enhanced structural adjustment facilities.

10. Eligibility of enhanced surveillance procedures for contingency mechanisms

The attachment of contingency mechanisms to the procedures for enhanced surveillance would be examined further in the context of the review of enhanced surveillance.

11. Coverage

As a general principle, contingency mechanisms would cover unanticipated changes in the exogenous components of a few key external variables: export earnings, import prices, and interest rates. Other current account transactions (such as tourist receipts and migrant workers' remittances) could also be covered where they are of particular importance. Capital movements and unanticipated shifts in the volume of imports of goods and services would not be covered. Natural disasters would not be covered by contingency mechanisms, but could give rise to assistance under the Fund's decision on emergency assistance related to natural disasters.

Coverage in the context of a particular Fund arrangement would be determined on a case-by-case basis, in discussion with the authorities. In all cases, the specific set of variables selected would need to cover a substantial proportion of the exogenous components of the country's current account. At the same time, the authorities and the staff would have sufficient flexibility in determining coverage to avoid complications in the calculations of baselines and contingencies that could substantially delay agreement on programs and activation of the contingency mechanism. The subset of variables covered would be specified at the inception of the program and would remain unchanged throughout the life of the associated arrangement.

Contingency mechanisms would cover unforeseen changes in nominal interest rates, and would be limited to changes in benchmark international interest rates (such as the London interbank borrowed rate). Accordingly, unexpected deviations in interest costs stemming from changes in the risk premium, exchange rates, and unanticipated external borrowing would not be covered. Fund financing of interest rate contingencies would apply to deviations in net interest payments (payments on the gross external debt minus receipts on officially owned foreign assets) and would apply only to instruments that are affected by unforeseen changes in interest rates.

Contingent financing of interest costs would be subject to a cumulative sublimit of 35 percent of quota. When such a limitation applied, the calculation of the net aggregate contingent deviation would be modified so as to avoid triggering the symmetric provisions of the mechanism in situations where the country would otherwise have experienced a contingent shortfall. Countries would be encouraged to hedge a part of their foreign debt against unforeseen rises in world interest rates, on the basis of the several instruments available in world financial markets. Although parallel contingent financing from commercial banks will be pursued vigorously, generally such financing would not be a prerequisite; in cases where the contingency financing that could be made available by the Fund would be small in relation to the effects on the member's external position of changes in international interest rates and where therefore parallel financing would be necessary to ensure adequate financing of the program, there would be a requirement for advance coverage of interest rates and other contingencies by mechanisms established with commercial banks.

12. Calculation of contingent deviations

Contingent deviations for individual current account variables would be calculated in relation to a baseline projection specified at the inception of the program. The aggregate size of the contingent deviation for a particular member would then be calculated as the net sum of deviations from baseline values for individual variables.

In preparing the baseline projections the staff would draw on World Economic Outlook forecasts of key variables, supplemented as appropriate by country-specific variables, and taking into consideration the country's circumstances. The key world economic outlook projections would be updated as necessary to provide an adequate basis for the calculations. The baseline normally would be specified for a period of 12 months, and in any case no longer than 18 months. Extended arrangements and arrangements under the enhanced structural adjustment facility (and where appropriate, those under the structural adjustment facility arrangements) would call for specification of annual baselines at the beginning of each program year.

In calculating the contingent deviations, the staff will adhere to the principle of exogeneity. Application of this principle would be straightforward for most import prices and export prices of key internationally traded commodities. For countries with a diversified export base (typically including a substantial proportion of manufactures), the staff will estimate the impact of unforeseen changes in external demand on export earnings. As regards interest rates, the contingent deviation would be calculated by multiplying the stock of net external debt specified in the baseline by the unexpected deviation in the nominal London interbank borrowed rate (or the appropriate benchmark rate where liabilities are denominated in currencies other than the U.S. dollar). When necessary, the calculation of contingencies would take into account information (particularly with respect to longer-term contracts) about the lags with which changes in world prices and international interest rates have an effect on the member's current account.

13. Compensatory financing element

In situations where the member's record of cooperation in recent periods had been unsatisfactory, or where its policies were seriously deficient, the compensatory financing element is to be made available in two tranches of equal size (each 20 percent of quota), given reasonable assurance that policies corrective of the member's balance of payments problems would be adopted.

14. Approval in principle

When compensatory financing requests are accompanied by Fund arrangements approved in principle, purchase of the full compensatory financing element (40 percent of quota) would be allowed for members with a good record of cooperation, and purchase of the first tranche (20 percent of quota) of the compensatory financing element would be allowed for other members.

15. Cereal decision

Overall access under the cereal decision and the compensatory and contingency financing facility will be 122 percent of quota, as set out under Alternative A in the Annex to EBS/88/100. Symmetry with the agreement to maintain access at its current level of 83 percent of quota for export shortfalls for members with a satisfactory balance of payments position except for the effects of the export shortfall would suggest leaving in place the existing access limit of 83 percent of quota for cereal excesses and the existing joint limit of 105 percent of quota for members with a satisfactory balance of payments position except for the effects of the cereal excess/export shortfall. This approach implies a potential to include access for contingency financing up to an overall access limit of 122 percent of quota.

16. Transitional arrangements

Under transitional arrangements, (i) there would be access of 40 percent of quota for contingency financing for countries with outstanding compensatory financing purchases of more than 65 percent of quota at the time the new decision is approved; and (ii) compensatory financing requests on which discussions were initiated before the approval of the new decision would be governed by the current compensatory financing decision for a period of three months after the approval of the new decision.

17. Calculation of compensable export shortfalls

a. Projection limits

There would be an upper limit on the projections of export earnings to be used in the calculations of export shortfalls. The limit on the projected growth of the average level of exports in the two postshortfall years over the average level of exports in the two preshortfall years would be set at 20 percent. Periodically, this limit would be reviewed, and if necessary revised, in the light of developments with respect to world inflation.

b. Adjustment for overcompensation and undercompensation

A compensatory financing request based on a shortfall falling within or overlapping with the two-year projection period of an earlier purchase would be adjusted by the amount by which the earlier purchase may have been overcompensated. Similarly, any undercompensation of the first purchase would be added to the subsequent shortfall when determining the size of the second purchase.

18. Avoidance of double compensation in compensatory and contingency financing

In calculating compensable amounts under the new facility, the staff will apply procedures to avoid double compensation between compensatory, including with respect to cereal costs, and contingency financing along the lines outlined in EBS/88/100. Under the procedures, a member with a contingency mechanism that includes export earnings as a variable should be able to be compensated under both contingency and compensatory financing, provided the amounts compensated under one component are deducted from the amounts to be compensated under the other. The member will have the choice to classify the amount of compensation deemed common to both contingency and compensatory financing as a purchase under either component.

The Chairman's Informal Remarks on the
Compensatory Financing Facility
and External Contingency Mechanisms

I would intend that these informal remarks be provided to the members of the Interim Committee as background. Our recent discussions lead me to believe that there is broad agreement in the following areas:

(1) On general principles, we have agreed that the essential features of the compensatory financing facility should be preserved; that contingent Fund financing could help maintain the momentum of adjustment programs against adverse external shocks; and that the basic features of contingency mechanisms should include an appropriate blend of adjustment and financing, symmetry, and a focus on disturbances above a minimum threshold level involving external factors beyond the control of authorities.

(2) On the operational framework, there has been broad support for an approach that would combine compensatory and contingency elements into a single facility, attaching the contingency element to Fund-supported adjustment programs. On overall access, agreement might be found on a figure of 105 percent of quota. The amount available under compensatory and contingency elements would each be 40 percent of quota and an optional tranche to supplement either element at the choice of the member would be 25 percent of quota.

(3) On the compensatory financing facility, the guidelines on cooperation approved by the Executive Board in 1983 would continue to apply to compensatory financing purchases. In applying the guidelines it would be the intention to ensure that purchases under the compensatory financing facility continue to provide timely compensation for export shortfalls while at the same time providing reasonable assurance of protection of the Fund's resources. The application of the guidelines which would govern access to the compensatory financing facility is set out in the Attachment. If a member decided also to apply the optional tranche to the compensatory financing facility, then that tranche would become available upon either approval or review of a program supported by the use of Fund resources or, in the absence of such a program, upon the Fund being satisfied that equivalent requirements had been met. It should be understood that where a member has a satisfactory balance of payments position except for the effect of the export shortfall, the member would continue to qualify for an outright purchase of 83 percent of quota.

(4) On the question of access to contingency financing, provision for such financing in a Fund arrangement would create a positive presumption of contingent financing for specified amounts which would be established on a case-by-case basis, taking into account the need for an appropriate mix of adjustment and financing and the member's capacity to meet its obligations to the Fund, and would not generally exceed 70 percent of the access under the associated basic arrangement.

After it appeared that a specified contingency was arising, a review by the staff would be carried out and Executive Directors would be asked to decide whether a contingency mechanism purchase was justified, the amount that was justified, the extent to which existing performance criteria might need to be modified, and the understandings that might need to be reached with the authorities on adaptation of policies. Such reviews would normally be conducted within the context of a midterm program review, although in some cases it might be useful and appropriate to conduct an ad hoc review in order to expedite the process. In some exceptional cases, an attempt would be made to specify at the outset of the program the link between additional financing needs and the relevant contingencies and the policy actions that would need to be phased in should the contingencies arise. Where this specification could be done with sufficient precision, disbursement of contingent financing could proceed once it had been ascertained that performance criteria had been observed for the relevant period of the arrangement. In such cases, the staff assessment could be expedited and, after the Board had been informed, disbursements would be made. In all cases, disbursements would of course require observance of relevant performance criteria.

There are still a number of important matters that remain to be discussed, including the mechanism for symmetry and the extent and nature, of coverage for interest rate developments.

It would be my intention after the Interim Committee meeting to ask the Executive Board to consider further the modalities and operational elements of external contingency mechanisms.

Attachment

Application of the Guidelines on Cooperation for the Compensatory Financing Facility

I would like to elaborate on my comments on how the guidelines on the test of cooperation would relate to the compensatory financing facility, based on evolving experience. As I said, there would be no need for a change in the letter of the guidelines but we would need to interpret them in a manner that both ensures timely access for the member and provides an adequate degree of protection for the Fund's resources.

Except as provided for below, a request by a member experiencing balance of payments difficulties that go beyond the export shortfall would be presumed to satisfy the guidelines and a drawing for the full amount of the compensatory element would be available immediately if the export shortfall were temporary, largely attributable to circumstances beyond the member's control, and the member was willing to cooperate with the Fund in an effort to find an appropriate solution to its balance of payments problems. The optional tranche would become available, as appropriate, in accordance with paragraph (3) of the main text.

On the other hand, if there were substantial indications that the member's record of cooperation in recent periods had been unsatisfactory, or that its existing policies were seriously deficient in relation to the size of its existing or prospective payments imbalances, then, consistent with the guidelines, we would continue to expect prior actions that would provide "reasonable assurance" that policies corrective of the member's balance of payments problems would be adopted. In these circumstances, access to the compensatory element would be in two tranches. The first would be disbursed as soon as appropriate prior actions are taken. Disbursement of the second tranche would take place according to the present guidelines and practices relating to the upper compensatory tranche. It would generally be expected that in these cases the optional tranche would become available upon program review.

It will be important in all cases to pay due attention to the member's capacity to service its debt obligations to the Fund.