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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 87/33

10:00 a.m., February 26, 1987

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

Executive Directors	Alternate Executive Directors
A. Abdallah	
	Song G., Temporary
C. H. Dallara	M. K. Bush
J. de Groote	G. Seyler, Temporary
A. Donoso	E. Feldman
	T. Alhaimus
	B. Goos
	A. Iljas, Temporary
A. Kafka	H. A. Arias
T. P. Lankester	M. Foot
H. Lundstrom	
M. Massé	D. McCormack
	A. R. Ismael, Temporary
	I. A. Al-Assaf
G. Ortiz	
H. Ploix	S. de Forges
G. A. Posthumus	
	I. Sliper, Temporary
G. Salehkhou	
A. K. Sengupta	
K. Yamazaki	
S. Zecchini	

L. Van Houtven, Secretary
K. S. Friedman, Assistant

Also Present

European Department: L. A. Whittome, Counsellor and Director. Exchange and Trade Relations Department: W. A. Beveridge, Deputy Director; M. Guitián, Deputy Director; J. Berengaut. External Relations Department: H. P. Puentes. Fiscal Affairs Department: V. Tanzi, Director. Legal Department: F. P. Gianviti, Director; W. E. Holder, A. O. Liuksila, S. A. Silard, J. V. Surr. Research Department: J. A. Frenkel, Economic Counsellor and Director; A. D. Crockett, Deputy Director; L. Alexander, N. M. Kaibni, R. Pownall. Treasurer's Department: D. Gupta. Western Hemisphere Department: E. Wiesner, Director; S. T. Beza, Associate Director; H. Arbulu-Neira, M. Caiola, J. Ferrán, D. N. Lachman, B. C. Stuart. Personal Assistant to the Managing Director: R. M. G. Brown. Advisors to Executive Directors: A. Bertuch-Samuels, M. B. Chatah, K. Murakami, D. C. Templeman, N. Toé, A. Vasudevan. Assistants to Executive Directors: J. R. N. Almeida, H. S. Binay, J. de la Herrán, F. Di Mauro, W. N. Engert, M. Hepp, G. K. Hodges, S. King, A. Kyhlberg, V. K. Malhotra, T. Morita, B. Tamami, D. A. Woodward.

1. ARGENTINA - PURCHASE TRANSACTION - COMPENSATORY FINANCING FACILITY - AMENDMENT OF DECISION

The Executive Directors considered a staff paper containing a draft decision amending the decision adopted at EBM/87/29 (2/18/87) approving in principle Argentina's request to make a purchase under the compensatory financing facility (EBS/87/17, Sup. 2, 2/25/87).

The Chairman noted that the proposed decision would amend paragraph 3 of the decision adopted on February 18, which provided that approval of the purchase under the compensatory financing facility would become effective on the date that the stand-by arrangement with Argentina became effective or "on a date to be determined by the Executive Board," whichever was earlier. The proposal was to include the date of July 15, 1987 as the date determined by the Executive Board.

Mr. Feldman made the following statement:

> I would like to thank the Executive Directors for meeting today to consider again Argentina's program. The Minister of Economy announced yesterday a new set of measures, some of which have been implemented over the previous several days and the final implementation of which will be completed by tomorrow. During the discussion of Argentina's request for a stand-by arrangement and a compensatory financing facility drawing last week, the consensus among Executive Directors was that there was not much room for new slippages in the economic program. The new set of measures has to be understood as a quick reaction by the economic authorities to the need to reinforce the economic program and to safeguard it from the danger that could arise from the acceleration of inflation in January and February 1987.
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> In January, the inflation rate was 7.6 percent--as measured by the cost of living index--and the information available for the first three weeks of February suggest that the inflation rate will run at no less than 6 or 6.5 percent for the month, which would yield accumulated inflation for the first two months of the year of about 13 percent. It became clear to the economic authorities that the acceleration of inflation was causing uncertainty, and that the economic policies designed at the beginning of the year, especially the wage guidelines for the coming months, would have become practically unsustainable. Hence, the idea behind this package is not to introduce a new economic program. I would like to stress this point: the economic program set at the beginning of the year is still in force; the new measures are to strengthen and reinforce that program, so that it will remain on track, especially in the second quarter of 1987.

Had the economic authorities not taken these measures so quickly, wage claims for the second quarter would likely be so strong as to jeopardize the entire program. The various fiscal, monetary, trade, wage, and price measures are intended to protect the program and to reach the objectives that were stated at the beginning of the year--economic growth of 4 percent for the year, and a rate of inflation for the whole year of about 40 percent, which means that after the inflation results of January and February, there is room for price increases in the coming months of approximately only slightly more than 2 percent a month.

I would like to stress that the new wage and price freeze is different in nature from the freeze that was implemented at the beginning of the Austral Plan in 1985. The difference is that the new freeze will be short, as the Government is freezing wages and prices for a preannounced period. Wages will remain frozen from now to the end of June. Hence, it is clear from the beginning, as suggested in the Minister's speech yesterday, that wages will be frozen only for 120 days. In mid-May, enterprises and trade unions will be invited by the Government to resume talks to restore the free collective bargaining process, as was explained and commented on in the letter of intent of January 12. The idea is to move toward these negotiations in a different atmosphere and situation--election year in Argentina, and it is very important politically to hold free negotiations of wages. But it is also important for this to happen in a context of a much lower rate of inflation. We expect that when talks between workers and employers resume, the inflation rate in Argentina will be no more than 2 percent a month; the discussions will thus be carried out in a more stable environment, thereby avoiding the expectations and claims that could have been derived from the rate of price increase that Argentina was experiencing in January and February.

More important, it is expected that at the end of the freeze, employers will face a more competitive environment than last April, when prices were made more flexible. It is with that aim in mind that the Minister of Economy announced several measures to increase the openness of the economy. These include the temporary admission of nontaxed imports from Brazil--to be used as inputs for exports--and the elimination of tariffs on imports of capital goods. The Government is firmly committed to speeding up the introduction of structural measures, and it is apparent that a lower rate of inflation will facilitate this decision. The economic authorities are convinced that priority must be given to structural measures, which would tend to consolidate the long-term trend of economic growth and price stability.

But it is important to stress that prior to the enforcement of the wage and price freeze, several corrective actions, especially in the form of increases of prices, took place. Prices of a large number of goods were allowed to increase before the enforcement of the freeze, and a rise in the prices charged by public utilities of 2 percent--and 15 percent in the case of oil--was also decided. The latter will facilitate the fulfillment of the fiscal targets for the second quarter of the year.

Wages measured in the traditional way are expected to fall slightly after March; this is not the case for the "purchasing power" of wages, given the expected positive effect of the price freeze. Nominal wages were corrected only very slightly before the freeze, to take account of the deterioration that occurred during the first two months of the year. The wage correction is the difference between the increase in wages granted at the beginning of the year and the increase in prices that actually occurred during January and February.

Another important measure adopted by the economic authorities is the correction of the exchange rate. The rate has been corrected since the beginning of the year through minor devaluations; before the wage and price freeze the rate was devalued by an additional 7 percent, which implies that from January 1 until the moment of the freeze the Argentine austral will have been devalued by about 21-22 percent, compared with an increase in the rate of inflation for the same period of about 13 percent. This means that the exchange rate is entering the freeze period with a considerable buffer.

While wages are going to be frozen for 120 days, the exchange rate will be kept fixed for only two months. During May and June, the exchange rate will be corrected by 2 percent a month. The idea here is to try to avoid the accumulation of imbalances that the economy experienced during the previous freeze and to start moving and correcting the exchange rate toward June, in line with the expected rate of inflation.

Monetary policy will be conducted as planned, in the sense that the expansion of domestic credit is expected to be in line with the projected decline in the rate of price increases. But the central bank is setting a lower rate of interest for loans and deposits in the regulated markets. The deposit rate will be 3 percent a month, while the lending rate will be 4 percent. It is expected that these regulated rates will be below the non-regulated rates, which will be about 5 or 6 percent a month for lending when the markets reopen tomorrow; this means that we will still have very high interest rates in real terms in the financial markets in Argentina.

This decision concerning interest rates is complemented by important new measures affecting the financial market, as a new round of deregulation is taking place. As I explained last week, there has been a major move since last October in this direction, when compulsory reserves on increases in nonregulated deposits were practically eliminated. Now, to complement this measure and to widen the nonregulated segment of the financial markets, banks will be allowed to operate in all kinds of public bonds. They will be permitted to buy and sell bonds in futures markets and in spot markets, which means that a market for futures will develop within the institutionalized financial markets. Operations in nonregulated markets will be much wider, and the economic authorities expect that this will contribute to the transparency and competitiveness of the financial markets.

The idea, then, is to have all these measures in place starting tomorrow. Some of the measures that I have described have already been implemented, and some are going to be put in place tomorrow, because the foreign exchange and bank markets are closed today and were closed yesterday, before the Minister delivered his speech to the public.

I would like to stress that, according to the available data for the last 45 or 50 days, the program seems to be on track for the first quarter. The new set of measures is intended to avoid deviations in the second quarter. The danger stemming from the much higher than projected rate of inflation was that the targets for tax collection for the second quarter could not be met, and the central bank would have to raise nominal interest rates, which would in turn have had a negative impact on the "quasi" fiscal deficit, that is to say, the operating losses of the central bank. By taking all these actions quite quickly and at once, we are preventing the economic program moving off track. There is great confidence that all these domestic measures, the implementation of which will be completed by tomorrow, will bring more credit to the plan, which would have otherwise experienced serious slippages. On the other hand, the economic authorities also believe that to build steady credibility these measures will have to be complemented by good news from the international financial community. That is why it is of utmost importance for Argentina's program to have more certainty about the future disbursements by the commercial banks and the international organizations we are talking with; this is especially true for the compensatory financing facility. Of course, having greater certainty about the use of the facility would definitely facilitate the Government's efforts to improve and complete the arrangements for a bridging operation with a group of governments.

Mr. Kafka said that the proposed decision was acceptable.

Mr. Zecchini commented that the staff should circulate in coming weeks its comments on the set of measures that the Argentine authorities were adopting. The staff's comments should focus on the consistency of those measures with the terms of the stand-by arrangement.

Mr. Lankester remarked that it would be useful to have the staff's initial comments on the measures at the present meeting. In particular, he wondered whether the new measures were consistent with and would strengthen the agreed program.

Mr. Posthumus said that it would be useful to have a further explanation of the reasons for the acceleration in the rate of inflation in the first two months of 1987. He wondered whether the method of meeting the public sector's financing requirement might not have been a factor.

Mr. Feldman remarked that there was no evidence of slippages in the fiscal or monetary areas during the first 50 days or so of 1987, and, therefore, the high rate of inflation could not be attributed to deviations in monetary or fiscal policy. There had been significant increases in the price of meat, which was an important component of the price index; there had also been increases in other products, the supply of which was inflexible in the short run. Accordingly, the acceleration in inflation in January and February appeared to be traceable partly to the excess demand that had been evident in the economy toward the end of 1986. The widening of the gap between the official and parallel market exchange rates probably contributed to the expectations that had resulted in many price increases, particularly in the services area, in January 1987, especially during the first 15 days of the month, before Argentina signed the letter of intent with the Fund. During the second half of January, the gap between the official and parallel market rates had narrowed considerably. However, by then, expectations had already built up in many sectors of the economy.

Mr. Ortiz considered that it was particularly significant that the new wage and price freeze was different in nature from the previous freeze in the sense that it was to be maintained for a clearly defined period. Announcing in advance that the freeze would be lifted in June meant that the new freeze period would not be characterized by as much uncertainty as the previous freeze. Of course, making the new freeze temporary at the outset posed another set of problems, especially the possibility of speculation in the private sector. Apparently the new, temporary measures were meant to give the authorities a breathing space in which to implement the policy decisions that had been announced and to monitor developments on the external front, especially the negotiations with commercial banks and other financing sources. A further comment on the significance of the temporary nature of the wage and price measures would be helpful.

Mr. Sengupta said that he felt somewhat uncomfortable about the course of events with respect to Argentina. The authorities were clearly in favor of the proposed decision, and he was willing to support it if the authorities felt that the proposed decision was the best way in which to proceed. However, the case of Argentina raised certain fundamental issues that must be resolved at some stage. The Executive Directors would have a chance to discuss those issues during the next review of the compensatory financing facility, but they should be aware at present of the full implications of the approval of the decision under discussion.

The authorities were obviously adopting significant adjustment measures that would undoubtedly affect the inflationary and payments performance of Argentina in the coming several months, and it was clear that the staff believed that the new measures were reasonably adequate, Mr. Sengupta continued.

The new measures that the authorities were implementing clearly met the criterion of cooperation with the Fund under the decision on the compensatory financing facility. Accordingly, he wondered why management wants to permit Argentina to make a drawing under the compensatory financing facility only as late as July 15, rather than forthwith or in the very near future. Obviously there was a link between the implementation of Argentina's adjustment program and the country's negotiations with the commercial banks. The problem that the proposed approach caused for him was that, for the first time, a member was being asked to meet an exogenous criterion--a criterion beyond the requirements of the present decision on the compensatory financing facility--in order to make a drawing under the facility. That approach had broad implications for member countries. In his view, it was not appropriate to link the use of the compensatory financing facility by a member country to the successful negotiations by the member with its commercial bank creditors. While he was willing to accept the proposed approach because the Argentine authorities themselves supported it, he hoped that the traditional practice of separating the use of the compensatory financing facility from negotiations with commercial banks would be maintained in future cases.

The staff representative from the Western Hemisphere Department remarked that the staff could make only a preliminary assessment of the measures, given that the measures had been announced only recently. Clearly, the authorities had reacted quickly to the higher than expected rate of inflation in the first two months of 1987. As the staff understood it, the new measures announced by the Minister of Economy were aimed mainly at preventing the recent large price increases from leading to future wage increases that would undermine the program that was agreed in January 1987. The new measures included a freeze on wages and prices through July, an adjustment of the exchange rate, a decrease in duties on imports of capital goods, an increase in public enterprise prices, and the introduction of a budget for rediscounts. The staff would be in contact with the authorities in coming days and expected to receive further details on the new policy package. The staff's initial assessment of the new measures was that they should provide greater assurance of the attainment of the program's monetary and fiscal policies than would have been the case without the measures.

Mr. Feldman said that the present wage and price freeze, unlike the previous one, would begin with a definite termination date. In his recent speech the Minister had not mentioned the planned termination of the freeze on prices, but it was understood that the freeze on both prices and wages was temporary. The authorities believed that there was a clear need to introduce greater flexibility into prices and wages. Hence, the intention was to make a commitment at the outset of the freeze period to the eventual freer determination of wages and prices. The intention also was to provide an environment for the next round of wage negotiations in which price expectations would be greatly lowered in comparison with the environment that prevailed in January and February, when the rate of inflation had been unexpectedly rapid. Without the freeze, the Government would have been hard pressed to resist trade union pressure to permit substantial increases in wages in response to the rapid rate of inflation. At the same time, the Government was accelerating the implementation of trade liberalization measures. For example, the tax on imports of capital goods was being eliminated, which should increase the discipline in price formation. Even more important, the authorities had agreed to eliminate temporarily the tax on imports from Brazil--provided the imports were eventually re-exported--within the framework of the integration agreement between Brazil and Argentina. That measure was in addition to the trade program that Argentina was implementing with the support of the World Bank.

The Chairman commented that the proposed decision was intended to facilitate the process of negotiation between Argentina and its creditors. In particular, it was meant to make a contribution to securing the bridge financing required until the stand-by arrangement for Argentina came into effect. Under the proposed decision, the approval of Argentina's purchase under the compensatory financing facility would become effective in any event not later than July 15, 1987, provided that Argentina had continued to cooperate with the Fund.

Of course, the potential providers of the bridge financing would wish to know what was meant by "cooperation" with the Fund in such cases, the Chairman said. If the Executive Board approved, he intended to tell Argentina's creditors that the requirement of cooperation with the Fund would be met if Argentina was in full compliance with the stand-by arrangement approved in principle by the Fund; or if Argentina's economic performance was broadly consistent with the objectives of the stand-by arrangement approved in principle by the Fund, but a waiver would be required in order to re-establish eligibility to draw under the stand-by arrangement if it were effective; or if Argentina was out of compliance with the stand-by arrangement, but was actively negotiating with the Fund measures to reach agreement on a revised or new stand-by arrangement. In each of those instances, the Executive Board would have to make a finding that Argentina was cooperating with the Fund. If, in his judgment, the requirement of cooperation was met in any of the three ways that he had described, he would so report to the Executive Board and recommend the adoption of a decision giving effect to the approval in principle, thereby authorizing the purchase by Argentina under the compensatory financing facility. The approach that he suggested was meant to be in keeping with the fact that cooperation with the Fund was essential.

Commenting on the selection of the date of July 15, 1987, the Chairman observed that two difficulties had arisen over the previous several weeks. First, the rate of inflation had been accelerating at the time that the stand-by arrangement for Argentina had been approved in principle. He had discussed that problem with the authorities, who had reacted promptly to protect their adjustment program through the measures that Mr. Feldman had described. Second, a bridging operation was needed because of the low level of reserves. He had thought it appropriate to attempt to meet the request of the potential suppliers of bridge financing for a certain date on which Argentina could use the compensatory financing facility, while maintaining the established principles and safeguards in the area of compensatory financing by the Fund. It was important for the sources of bridge financing to know of a date for the disbursement of what would be the second pillar of the bridge financing.

In proposing the date of July 15, 1987, which fell before the Executive Board's next review of the compensatory financing facility, he had been careful to take three basic steps, the Chairman remarked. The first was to exclude the option of an immediate disbursement and to maintain the pressure for active negotiations with the banks. That approach was consistent with the thrust of the Executive Board's decisions on Argentina adopted on February 18, 1987. In that connection, care was taken to avoid acting inconsistently with the quick-disbursing character of the Fund's compensatory financing. The second step was to maintain the central criterion of cooperation. The third step was to accept a certain outside date which, when reached, would permit the purchase to occur even though Argentina still lacked the external finance necessary to close the financing gap. After reviewing recent experience of the lag between the end of the shortfall year and the purchase date, it was decided that the date of July 15 would be appropriate. He hoped and expected that the critical mass of financing would be obtained before that date.

Approval by the Executive Board of the approach that he had suggested would not prejudge the outcome of the coming review of the compensatory financing facility, the Chairman said. That review would give Executive Directors an opportunity to express their views on the general aspects of the policies governing compensatory financing.

Mr. Salehkhou stated that he continued to support fully Argentina's adjustment program. However, he shared Mr. Sengupta's apprehension about the proposed approach to dealing with Argentina. It was true that in some previous cases requests for stand-by arrangements and purchases under the compensatory financing facility by a single member country had been considered together by the Executive Board, but he doubted whether the simultaneity of the approval had been formally established by the adoption of a decision to that effect, as was the case with Argentina. The present approach certainly should not set a precedent for the future handling of requests to use the compensatory financing facility. Time was clearly needed to complete the arrangements for the bridge financing, but he was worried that the connection between those efforts and the approval of the compensatory financing for Argentina might set a precedent for future cases. The Chairman's assurances in that connection were welcome, but he was worried about the possibility that a precedent would be established nevertheless. It was conceivable that commercial banks would push the

Fund to require members to adopt stand-by arrangements or to use the compensatory financing facility--decisions that were clearly not in the competence of the commercial banks.

Mr. Massé said that he, too, thought that the proposed decision raised difficult issues. He had hesitated to accept the proposed decision in considering how to balance the pragmatic need to help Argentina to deal with its present problems--the first step toward which was obviously to obtain bridge financing--against the slightly greater risk than usual that the Fund had to run in assisting Argentina. In considering the proposed decision he had taken into account the concerns that had been described by the Chairman and the fact that the proposed period should prove to be long enough to enable the authorities to reach the critical mass of financing and therefore would not create a precedent for the normal operations of the Fund. The Chairman's comments on the interpretation of "cooperation" with Argentina indicated that by the specified date, if a minimum of cooperation was judged to exist, the purchase under the compensatory financing facility would be authorized. Despite the slightly greater risk for the Fund under the proposed approach--a risk that might affect the Fund's credibility and standing--he had come to the conclusion that such a risk was the price to be paid for the proper functioning of the international monetary system, for the proper type of relationship between the Fund and Argentina, and for the proper kind of help that the Fund could give to member countries. Hence, he supported the proposed decision.

Mr. Zecchini remarked that he would make three points. First, his authorities continued to endorse fully the adjustment efforts that were being made by the Argentine authorities. The recently adopted measures were welcome, especially as close attention was being paid to the existing distortions in the economic processes and mechanisms in Argentina and the authorities were attempting to broaden the range of policy instruments by explicitly making allowance for a more constructive and extensive use of incomes policy. The wage and price freeze--including the terms on which it was established and was to be phased out--was based on the idea of using incomes policy to guide expectations of wage earners and producers with respect to the development of the current business cycle. He looked forward to having a further discussion on the implications of the new policies.

Second, the proposed decision, together with the Chairman's qualifications and explanations about the meaning of "continues to cooperate," reflected more fully than the previous decision on Argentina the spirit of the Executive Board's decision on the test of cooperation, Mr. Zecchini continued. As he understood it, given the spirit and the letter of the decision on the test of cooperation, there was no need for a member to have a stand-by arrangement in order to make a drawing under the compensatory financing facility; the decision explicitly provided that a stand-by arrangement was not a necessary condition for a drawing under the compensatory financing facility. In substance, what was important was the cooperation of the country in adopting measures that were appropriate to deal with the member's external imbalance and with its capacity to service the new debt that was being added to the previous stock of debt. In that connection, the proposed revised decision for Argentina was an improvement over the original text, because it gave the Fund more room in which to consider the actual policies that were implemented rather than the full-fledged stand-by arrangement, the implementation of which was conditional upon the achievement of a critical mass of financing that required the support of the entire financial community. Accordingly, he could go along with the proposed decision.

Third, the introduction of a deadline--namely, July 15, 1987--was not a major departure from past practice, Mr. Zecchini commented. Even if the reaching of the deadline could not trigger a drawing under the compensatory financing facility, there would be nothing to prevent the Argentine Government from making a new request for compensatory financing based on the parameters that would be applicable at the time of that new request. At the same time, there would be nothing to prevent the Fund agreeing to the new request, provided that the test of cooperation was met.

Mr. Kafka said that basically he agreed with the substance of Mr. Zecchini's comments. An institution like the Fund must run the kind of risk that Mr. Massé had described. If it failed to do so, the Fund could not serve the purposes for which it was established. Until the Executive Board had adopted in recent years decisions undermining the compensatory financing facility, that facility had been a bridging facility; in the absence of those adverse decisions, the compensatory financing facility could have been used in the present case of Argentina, especially as in substantive terms Argentina had already obviously fully met the requirement of cooperation with the Fund.

Mr. Sengupta remarked that he fully understood the approach that the Chairman wished to take. If the compensatory financing could facilitate the bridge financing by providing some flexibility or maneuverability in Argentina's dealings with its commercial bank creditors, there was no reason not to use it for that purpose. However, a number of Executive Directors had not welcomed the introduction of the relatively strict conditionality on drawings in the so-called upper tranche of the compensatory financing facility. In their view, the compensatory financing facility was different from a stand-by arrangement. The guidelines for the conditionality on compensatory financing stipulated that there was no need either to adopt a stand-by arrangement to meet the test of cooperation, or to show that a program under a stand-by arrangement had actually been implemented; instead, a member had to show its willingness to cooperate with the Fund in an effort to find appropriate solutions to its balance of payments difficulties. That approach should be protected and preserved. Since the Chairman intended to communicate to the commercial banks the message that he had described in his opening remarks, it might be unnecessary to include in the revised text of paragraph 3 of the decision a reference to the approval in principle of the stand-by arrangement for Argentina on February 18, 1987. The Chairman's communication to the authorities and the commercial banks would clearly show the conditions in which the cooperation requirement would be met. Accordingly, paragraph 3 could read: "This approval shall become effective on a date, to be settled by consultation, and in any event not later than July 15, 1987, provided that Argentina continues to cooperate with the Fund." That text would be consistent with the decision adopted on February 18, 1987, as the Executive Board would still have to meet to decide either to make the stand-by arrangement effective or to permit Argentina to use the compensatory financing facility. Under his revised text, the precise date of July 15, 1987 would be added to the decision.

Mr. Dallara considered that giving final approval to the requested purchase under the compensatory financing facility on the date that the stand-by arrangement became effective would not set a precedent. There had been five previous cases in which the Executive Board had simultaneously approved in principle a stand-by arrangement and a purchase under the compensatory financing facility and had subsequently given final approval in a manner that was consistent with the language of the decision on the compensatory financing facility.

Mr. Sengupta said that the issue raised by the case of Argentina was that the use of the compensatory financing facility was to be linked to a stand-by arrangement that would come into effect only upon the taking of certain actions by a third party, outside the Fund. The present case of Argentina would establish a precedent by involving not only a drawing under the compensatory financing facility but also an agreement to provide bridge financing. It was the exogenous factor in the form of the role of the commercial banks that made the present case of Argentina troubling.

Mr. Dallara commented that, as he understood it, there had been previous cases in which an agreement by commercial banks to provide financing was a critical factor in the effective date of a stand-by arrangement for a member.

Mr. Lankester considered that it was neither necessary nor desirable to change paragraph 3 of the proposed text in the way that Mr. Sengupta had suggested. It would be entirely appropriate for the authorization for Argentina to use the compensatory financing facility to become effective when the stand-by arrangement for Argentina became effective, and it would be advantageous to include language in the proposed decision to make that point clear. However, he had two concerns about the proposed decision. First, the drawing under the compensatory financing facility might take place before there was clear evidence that the bank financing package was likely to be finalized. That outcome was likely if the commercial banks still had not provided the necessary financing by July 15, 1987. Second, the drawing under the compensatory financing facility might be made at a time when Argentina's economic program was going off track and, as a result, Argentina faced the prospect of being unable to meet its debt service. In either of those situations, the Fund would be advancing financial resources when there was a clear risk that Argentina would be unable to make the necessary repurchases in due course. The provision in the draft decision for cooperation by Argentina with the Fund might meet the second concern that he had mentioned, but it was unlikely to meet the first one.

Of course, in the absence of the needed bank financing, the authorities might well find it difficult to make the scheduled repurchases, even if the program were on track, Mr. Lankester commented. Accordingly, his first preference was to adhere to established precedent, under which the purchase under the compensatory financing facility would become effective when the stand-by arrangement became effective. As a second best solution, given his concern about the bank financing, he preferred to make the compensatory financing available when the term sheet was agreed by the banks. That approach would not entirely alleviate his concern, since experience showed that a long period could pass between the agreement on a term sheet and the final implementation of a financing package. The third best solution was to decide that on July 15, 1987 Argentina would be permitted to make the purchase under the compensatory financing facility, provided that the Chairman could assure the Executive Board that Argentina was in compliance with the stand-by arrangement or that Argentina's economic performance was broadly consistent with the objectives of the program but a waiver was required and justified.

He was not attracted by the third definition of cooperation that the Chairman had mentioned, namely, that the cooperation requirement would be satisfied if Argentina were out of compliance with the stand-by arrangement but was actively negotiating with the Fund measures to reach agreement on a revised or new stand-by arrangement, Mr. Lankester went on. The text of that definition was excessively loose; it could be interpreted in a variety of ways. For example, the meaning of "active negotiation" was unclear to him. If the approach that the Chairman favored was to be used, he himself preferred to include the first two definitions of cooperation that the Chairman had mentioned and to exclude the third definition. Finally, he hoped that the recommendation with respect to cooperation that the Chairman would be making to the Executive Board would have to be formally approved by the Board.

Mr. Kafka stated that Mr. Lankester's proposal was not acceptable.

Mr. Zecchini commented that the points that Mr. Lankester had made could perhaps be better dealt with during the coming discussion on the compensatory financing facility. He did not agree with Mr. Lankester that there was necessarily a link between the approval of a stand-by arrangement for a member and the approval of a drawing for the same member under the compensatory financing facility. The implementation of a stand-by arrangement was not by itself a guarantee that a member would be able to make the necessary repurchases in respect of a purchase under the compensatory financing facility. In addition, the use of the compensatory financing facility was based on an assessment of the trend of exports and not on the difference between exports and imports. That was important not only for the calculation of the shortfall, but also as a matter of principle, as the compensatory financing facility was aimed exclusively at offsetting a temporary shortfall of exports compared to a trend line of exports. The decision on the compensatory financing facility said nothing about the direction of such trend lines. The case that Mr. Lankester was making seemed to go beyond the spirit of the decision on the compensatory financing facility in the sense that Mr. Lankester apparently had reservations about the way in which the staff estimated the direction of the trend line. Those reservations concerned the ability of the country using the compensatory financing facility to generate sufficient net exports after drawing on the facility, suggesting that the Fund might be placing itself at risk in permitting the member to use the facility. Those points should be discussed more extensively on another occasion.

Mr. Dallara said that he agreed with much of what Mr. Zecchini had said and looked forward to considering on another occasion the basic issues that had been raised during the present discussion. He welcomed the serious and timely manner in which the Argentine authorities had addressed the economic problems that had recently arisen in Argentina. The measures that Mr. Feldman had described were in the right direction to strengthen the program. Of course, the authorities had adopted many of the new measures in the light of their own perception of the growing problems in the economy, but it was useful to note that many of those measures met concerns that had recently been expressed by Executive Directors.

He was pleased that an approach to the purchase under the compensatory financing facility had been found that apparently was satisfactory to management, the authorities and the participants in the bridge financing for Argentina, Mr. Dallara continued. He hoped and expected that the purchase under the compensatory financing facility would be authorized on the date when the stand-by arrangement became effective. The recently announced measures showed the authorities' determination not only to deal with the problems facing the economy, but also to preserve their creditworthiness in the international capital markets. That determination would certainly be a positive factor in the ongoing discussions between the authorities and the banking community.

Nevertheless, in the event that the stand-by arrangement was not in effect by July 15, 1987, he welcomed the proposed approach under which the use of the compensatory financing facility on that date would be clearly linked with Argentina's continued cooperation with the Fund, Mr. Dallara said. The concept of cooperation had been central to the compensatory financing facility for a long time, and it was important to preserve that concept. At the same time, the clarification that had been given by the Chairman of the meaning of cooperation in the particular case of Argentina was welcome. The approach that the Chairman had described left some risk for the participants in the bridge financing but reduced it to an extent that would be consistent with the need to preserve the Fund's credibility. Mr. Lankester's concern about the approach to the present case was understandable, and while the proposed approach might not be ideal for either the Fund, Argentina, or the participants in the bridge financing, it did seem to reflect an appropriate balance of all the various considerations that had to be taken into account. It should be understood, given the concerns that were expressed during the previous discussion on Argentina, that the compensatory financing facility was not a substitute for the bridge loan; instead, it was an important factor in facilitating the coming into effect of the bridge loan. It would be important for the participants in the bridge financing to move promptly to provide that financing. His authorities were prepared to act immediately, and he hoped that, following the conclusion of the present discussion, other potential participants in the bridge financing would act promptly in the light of the Managing Director's comments and proposal at the present meeting. In addition, it was important to stress the importance of a prompt agreement between Argentina and the commercial banks on the basic financing package, as the bridge financing operation was by definition a transitional arrangement, pending a more definitive arrangement. Finally, the proposed decision was acceptable.

Mr. Ortiz remarked that Mr. Lankester seemed to have implied that Argentina's ability to make the scheduled repurchases would be endangered if the authorities did not reach an agreement with their commercial bank creditors by July 15. During the previous discussion on Argentina, the staff had noted that Argentina's obligations to the Fund were a small part of its total external debt obligations, and that in light of the country's record in meeting its obligations and the relatively comfortable level of its expected reserves, it was not envisaged that there would be difficulty in making repayments over the medium term. It was not appropriate to assess the prospects for repayment to the Fund on the basis of specific negotiations on a particular debt problem with commercial banks. A country's record in meeting its obligations to the Fund was an important factor in the staff's evaluation of the country's ability to repay the Fund. In the past, the linking of Fund financial assistance to a member country to the conclusion of an agreement by the country with its commercial bank creditors had forced borrowing countries to come to terms at a pace that might not have been in the best interests of the country.

Mr. Al-Assaf considered that the Chairman's definition of "cooperation" was appropriate. While the risks involved should not be discounted, the Fund had taken such risks before. He agreed with Mr. Zecchini that the present discussion was not the appropriate occasion on which to discuss the general issues concerning the compensatory financing facility; those issues should be taken up during the coming review of the facility. The proposed decision was acceptable.

Mr. Posthumus said that he accepted the draft decision and the Chairman's proposal. The risk for the Fund under the proposed approach should not be dismissed lightly. Argentina had a good record of cooperation with the Fund, and he agreed with Mr. Ortiz that the risk involved for the Fund should be accepted. The implementation of Argentina's current adjustment program was essential, as the Chairman had stressed in his concluding remarks at the end of the previous discussion on Argentina.

Mr. Lundstrom remarked that the measures that the authorities had announced on the previous day clearly demonstrated the seriousness of Argentina's situation. The measures confirmed the concern expressed during the previous discussion by a number of Executive Directors, including himself, about the insufficient strength and precision of Argentina's program. However, the implementation of the new measures--and the rapid pace at which they had been introduced--were evidence of the authorities' determination to bring the situation under control. On balance, he continued to believe that assisting Argentina was a high-risk exercise to which there was no better alternative.

He hoped that the stand-by arrangement would become effective well before the proposed date of July 15, 1987, Mr. Lundstrom said. If that were not possible, the provision that "Argentina continues to cooperate with the Fund" in the decision seemed to be an appropriate way in which to strike the required delicate balance between the principles to which the Fund had to adhere and the interests of the participants in the bridge financing. That balance was even more delicate in the context of the interpretation of "cooperation" that the Chairman had described--indeed, the balance was perhaps somewhat too delicate. Accordingly, he could accept Mr. Lankester's suggestion to drop the third interpretation that the Chairman had mentioned. The proposed amendment to the decision was acceptable.

Mr. Yamazaki commented that he shared the concerns that had been expressed by Mr. Lankester, Mr. Massé, and Mr. Zecchini. However, a majority of Executive Directors seemed to agree that the broader issues concerning compensatory financing should be discussed during the coming review of the facility. As Mr. Kafka had stressed, there were always certain risks involved in making Fund resources available to member countries, but the Fund should take the risks. At the same time, the proposed decision should not be seen as establishing a precedent, and it was on that basis that he could accept the decision.

Mr. Goos said that he accepted the draft decision and the proposal that the Chairman had made. The decision, together with the Chairman's interpretation of "cooperation," struck a reasonable balance between the conflicting interests of the authorities and the participants in the bridge financing. There was probably no way in which to avoid altogether any risks in assisting Argentina, and the main issue was how to distribute those risks among the various parties concerned. The proposal under discussion seemed to offer a fair and balanced solution. In the final analysis, the risk involved stemmed mainly from the possibility that the negotiations between the authorities and the commercial banks would not be completed by July 15, 1987. The authorities should make every effort to reach an early conclusion to the negotiations with the commercial banks, so that the stand-by arrangement could be made effective and the purchase under the compensatory financing facility could be made at the same time.

Mrs. Ploix recalled that during the previous discussion on Argentina, she had stressed that the durability of the gains that the authorities had made were at stake. Accordingly, the additional decisions that the authorities had taken in recent days were welcome, especially as they clearly showed the authorities' commitment to the successful implementation of their program. She had preferred to make the decision on Argentina's drawing under the compensatory financing facility effective forthwith. If the proposed decision was acceptable to the authorities and other Executive Directors, she was willing to accept it.

Mr. Song said that Argentina's record of cooperation with the Fund and the new measures introduced by the authorities clearly showed that Argentina had met, and would continue to meet, any test of cooperation. He wondered whether the approval of a stand-by arrangement in principle was acceptable evidence of cooperation, or whether that had to wait until the stand-by arrangement became effective. If approval in principle was sufficient, an early drawing under the compensatory financing facility by Argentina could be made. Given the present circumstances of Argentina, an early drawing would help economic performance and would be in the best interest of not only the Argentine people but also the international community including its financial sector.

Mr. Seyler said that his chair supported the proposed decision.

Mr. Sliper considered that the Fund needed to act quickly and pragmatically in such cases as that of Argentina. However, the growing practice in the Fund of evolving policy on the spur of the moment was a cause for concern. He was worried that the adoption of the proposed decision would prejudge the outcome of the coming review of the compensatory financing facility. By adopting the proposed decision the Executive Board would be changing the 1983 decision on compensatory financing with respect to the test of cooperation with the Fund. As to the three criteria that the Chairman had mentioned in clarifying the test of cooperation, he, like Mr. Lankester, had reservations about the third one, which would be difficult to put into operation.

The staff representative from the Research Department said that there had been five cases in which requests to use the compensatory financing facility had been approved in principle and four of the stand-by arrangements accompanying those requests had also been approved in principle. In those four cases, the disbursement of the drawings under the compensatory financing facility had been made when the stand-by arrangements had entered into effect, and the entry into effect had been contingent on financing being mobilized. In the remaining case, the stand-by arrangement had been approved outright, but the compensatory financing purchase had, exceptionally, been approved in principle only, subject to the outcome of a Paris Club meeting. The period between the approval in principle and the purchases under the compensatory financing facility had generally been within the guidelines for approval in principle, namely, roughly 30 days. In two cases, the period had been about two weeks while in other cases, the period had exceeded 30 days; the maximum time lag was about six weeks.

The Director of the Legal Department remarked that, under the practice of the Fund, when a stand-by arrangement was approved in principle, an accompanying request for a drawing under the compensatory financing facility was also approved only in principle, subject to the coming into effect of the stand-by arrangement. The first part of the proposed decision amending paragraph 3 of Decision No. 8532-(87/29) reflected that practice. Accordingly, deleting the first part of the decision, as had been suggested, would be a major deviation from existing practice. Moreover, using the words that Mr. Sengupta had suggested, "on a date to be settled by consultation and, in any event, not later than July 15, 1987," was inconsistent with the principle that the effective date of decisions adopted by the Fund should be determined by the Fund. Moreover, the text proposed by Mr. Sengupta would not clarify which parties would be involved in the consultation; if a solution along the lines of his amendment were approved, that point should be clarified.

Mr. Sengupta said that, as his proposal had not been supported by other Executive Directors, he wished to withdraw it.

Mr. Feldman commented that he had noted the concerns of Executive Directors about Argentina's performance under its adjustment program. It was important to stress that all the new measures were designed to consolidate the progress under the program. It was clearly in the best interest of the authorities themselves to make every effort to reach a rapid agreement with their commercial bank creditors. Accordingly, the authorities certainly hoped that the stand-by arrangement would become effective in the near future, so that the drawing under the compensatory financing facility could be made well before July 15, 1987. To that end, the commercial banks would have to show some understanding for the situation in Argentina and would have to respond quickly. Meanwhile, the proposed decision would meet Argentina's needs, as it would facilitate the effort to negotiate the bridge financing and to consolidate the adjustment program. The proposed decision was acceptable.

The Chairman remarked that Executive Directors' comments and reservations would be noted in the record. It was important to emphasize that the approval of the proposed decision and of his own proposal, which would be communicated to the authorities, should not prejudge the outcome of the coming review of the compensatory financing facility.

The Executive Directors then took the following decision:

Paragraph 3 of Decision No. 8532-(87/29), adopted February 18, 1987 shall be amended to read as follows:

> This approval shall become effective on the date when the stand-by arrangement set forth in EBS/87/5, Supplement 3, approved in principle on February 18, 1987 (Executive Board Decision No. 8530-(87/29)) becomes effective, or in any event not later than July 15, 1987, provided that Argentina continues to cooperate with the Fund.

Decision No. 8535-(87/33), adopted
February 26, 1987

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/87/32 (2/25/87) and EBM/87/33 (2/26/87).

2. MADAGASCAR - TECHNICAL ASSISTANCE

In response to a request from the Malagasy authorities for technical assistance in the fiscal field, the Executive Board approves the proposal set forth in EBD/87/52 (2/19/87).

Adopted February 24, 1987

3. APPROVAL OF MINUTES

a. The minutes of Executive Board Meetings 86/91 and 86/92 are approved. (EBD/87/46, 2/18/87)

Adopted February 24, 1987

b. The minutes of Executive Board Meetings 86/93 and 86/94 are approved. (EBD/87/47, 2/19/87)

Adopted February 25, 1987

4. EXECUTIVE BOARD TRAVEL

Travel by Executive Directors as set forth in EBAP/87/34 (2/24/87) is approved.

APPROVED: September 18, 1987

LEO VAN HOUTVEN
Secretary