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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 90/155

10:00 a.m., November 2, 1990

M. Camdessus, Chairman

Executive Directors	Alternate Executive Directors
M. Al-Jasser	
G. K. Arora	L. E. N. Fernando
C. S. Clark	
	Chen M., Temporary
T. C. Dawson	
J. de Groote	J. Prader
E. A. Evans	G. H. Spencer
R. Filosa	N. Kyriazidis
M. Finaish	
	I. H. Thorláksson
G. Grosche	B. Goos
J. E. Ismael	
A. Kafka	
J.-P. Landau	J.-F. Cirelli
A. Mirakhor	O. Kabbaj
L. B. Monyake	L. J. Mwananshiku
D. Peretz	P. Wright
G. A. Posthumus	
C. V. Santos	Y.-M. T. Koissy
A. Torres	R. Marino
A. Végh	A. G. Zoccali
K. Yamazaki	S. Yoshikuni

J. W. Lang, Jr., Acting Secretary
M. J. Miller, Assistant

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Also Present

V. Navratil, Director, Internationl Banking and Financial Institutions, State Bank of Czechoslovakia. IBRD: F. Lysy, Economic Advisory Staff. African Department: M. Touré, Counsellor and Director; E. L. Bornemann, Deputy Director; R. C. Williams. Asian Department: P. R. Narvekar, Director; W. Tseng. European Department: M. Guitián, Deputy Director. Exchange and Trade Relations Department: J. T. Boorman Director; E. Brau, Deputy Director, T. Leddy, Deputy Director; S. Eken, G. R. Kincaid, C. Puckahtikom. External Relations Department: D. M. Cheney. Fiscal Affairs Department: C. Liuksila, P. Stella. IMF Institute: O. B. Makalou. Legal Department: F. Gianviti, General Counsel; W. E. Holder, Deputy General Counsel; R. H. Munzberg, Deputy General Counsel; P. L. Francotte. Middle Eastern Department: M. D. Knight, S. K. Wajid. Research Department: J. A. Frenkel, Economic Counsellor and Director; R. Baban, N. M. Kaibni, J. Martelino, E. C. Meldau-Womack, P. R. Menon, B. E. Rourke, P. Wickham. Secretary's Department: C. Brachet, Deputy Secretary; B. R. Hughes, S. L. Yeager. Treasurer's Department: G. Laske, Treasurer; D. Williams, Deputy Treasurer; D. Gupta, G. Wittich. Western Hemisphere Department: S. T. Beza, Counsellor and Director; J. Ferrán, Deputy Director. Bureau of Statistics: J. B. McLenaghan, Director. Personal Assistant to the Managing Director: B. P. A. Andrews. Advisors to Executive Directors: M. A. Ahmed, L. E. Breuer, M. B. Chatah, A. Gronn, Z. Iqbal, A. R. Ismael, J. M. Jones, S.-W. Kwon, M. J. Mojarrad, A. M. Tanase. Assistants to Executive Directors: T. S. Allouba, H. S. Binay, G. Bindley-Taylor, B. A. Christiansen, H. E. Codrington, S. B. Creane, E. C. Demaestri, A. Fanna, S. K. Fayyad, B. R. Fuleihan, M. A. Ghavam, S. Gurumurthi, M. E. Hansen, A. Hashim, O. A. Himani, M. E. F. Jones, P. Kapetanovic, G. Lindsay-Nanton, G. Montiel, F. Moss, M. Nakagawa, S. Rouai, M. J. Shaffrey, Shao Z., C. M. Towe, S. von Stenglin, J. C. Westerweel.

1. EXECUTIVE DIRECTORS

The Chairman welcomed Mr. Mirakhor, Mr. Monyake, Mr. Santos, Mr. Torres, Mr. Végh, Mr. Koissy, Mr. Marino, Mr. Mwananshiku, Mr. Spencer, and Mr. Zoccali to the Executive Board.

2. REPORT BY MANAGING DIRECTOR

The Chairman stated that he had visited Venezuela at the invitation of President Carlos Andres Perez, who had wished to meet with him to discuss developments in Venezuela since they had met about eighteen months previously, before the launching of the program for Venezuela. He had also taken the opportunity of his visit to address the Venezuelan Managers Association, during which he had explained the Fund's strategy to the unions of workers and business owners. He had continued to discuss with the authorities the best strategy for Venezuela in dealing with the windfall temporary profits linked to recent developments in the Middle East. He had reached understandings with the authorities on the best use of those resources, which would be reflected in a letter of intent which the Board would receive soon.

He had also discussed with the authorities the contribution Venezuela could make, in spite of its current difficulties, to solving the problems of neighboring countries, the Chairman continued. Both Mexico and Venezuela were already contributed, especially with respect to their involvement in the support group for Peru, assistance to Nicaragua, and a possible contribution to the Fund's Subsidy Account. President Perez had been responsive to the possibility of such a contribution. He had also agreed that Venezuela ought to assume a fair share of support for the countries in the region in difficulties, provided that the beneficiaries would apply to themselves the same discipline that Venezuela, had applied to itself, and indeed, was continuing to apply in the framework of Fund-supported arrangements.

He had been impressed by the extent of the progress made in Venezuela since the beginning of the program, the Chairman concluded. The ultimate success of the program would depend upon its deepening and strengthening in the remaining two years of the extended arrangement. In that respect, he had been impressed by the support of the workers' union for the program, and their recognition that adjustment was necessary. Unfortunately, such support was somewhat less evident on the business owners' side, where a cultural change might have to precede a change in sentiment about the adjustments needed. The view of the business community was that it made no sense for a country with such oil wealth to implement a value added tax, and that the solution was rather a cutting of expenditures to bring them into line with oil receipts. He had argued that, given the internal problems and social needs of Venezuela, such a course of action would be clearly inappropriate. Obviously, progress was still needed, but Venezuela was committed to remaining on the path of radical change that it had decided to follow.

3. FUND RESPONSE TO RECENT DEVELOPMENTS IN MIDDLE EAST

The Executive Directors considered a staff paper on the response of the Fund in the wake of recent developments in the Middle East (EBS/90/179, 10/16/90; Sup. 1, 10/29/90; and Sup. 2, 10/29/90), and the preliminary views of the Managing Director on a temporary subsidy account for low-income and lower-middle income countries affected by recent developments in the Middle East.

The Chairman stated that he was hopeful that the Board's present discussion would allow the Fund to move forward quickly in helping members' adjustment efforts in the present difficult circumstances. "Quickly" and "expeditiously" were the key words of the Interim Committee and of many interventions during the Annual Meeting. There were expectations in the media that the Fund would soon be in a position to announce how it intended to assist countries adversely affected by recent developments. Although he did not wish to encourage such expectations, and in fact deplored them, their existence needed to be recognized. He hoped that the Board would be able to confirm the acceptability of a package along the lines of those put forth in the staff paper at the end of the discussion, both in order to meet the call of the Interim Committee, and also to provide guidance to the staff in the discussions currently underway with many of the Fund's members. There were many missions at present in the field waiting for the result of the Board's discussions. The mere fact that the Fund had been able to send missions immediately to the field had been of comfort to many governments, and a way of avoiding too much speculation and agitation about the support the countries might be able to secure from the international community. The proposal in the staff paper reflected both the preliminary discussions in the Board on what should be the Fund's response, and also the guidelines the Fund had received from the Interim Committee.

The proposals were built on the consideration that the systemic implications of oil market developments would be relatively limited, and the overall situation manageable, the Chairman continued. If it became obvious after a few months that that consideration was wrong, the issues would have to be revisited. He believed that it was important that the response be tailored to the foregoing consideration, and that the Fund not react to events in a way that altered the basic principles of either the Fund's action or its facilities. The present oil shock was too circumstantial to allow the invention of new principles for action. The Fund could respond on an accelerated basis to the present difficulties through the use and appropriate adaptations of its existing instruments. Given the complex nature of the situation in the Middle East, it was difficult to project with confidence the future path of oil prices. The

Fund therefore needed mechanisms to assist its members appropriately as events unfolded, and not only on the basis of current developments. The lessons of the past-- experience with and considerations of exposure, and the need to safeguard the Fund's resources--pointed strongly to the provision of added financing by the Fund, primarily in the context of comprehensive adjustment programs. A large number of members presently had in place Fund arrangements, along with the policy framework under which suitable modifications in adjustment measures and Fund financing could be introduced relatively quickly. He had a strong preference for operating through those channels.

On the basis of those considerations, he continued to believe that the proposed modalities constituted an expeditious and effective response to recent developments in the Middle East, the Chairman commented. However, he was aware that some Directors would favor more fundamental changes in, and adaptations to, existing instruments. He would like to have the views of the Board in that regard. The staff had also put forward the considerations behind proposals that went further than those already on the table. He would hope that whatever tack that was taken in the discussions, the Board would be able to move forward quickly with the necessary decisions. He would like to adopt quickly decisions on mechanisms which the Board could agree on at present. If there was strong support for more far-reaching mechanisms in precise enough terms, the staff would stand ready to put them in force without delay. It was also prepared to put other proposals on the drawing board.

Directors had received his memorandum outlining his proposals to establish a mechanism through which the Fund could assist some members adversely affected by recent developments to meet the cost of Fund resources that might be made available to support their adjustment efforts, the Chairman concluded. Directors had already reacted informally and in a preliminary way to those proposals. He hoped that, in their interventions, Directors would be able to provide the staff with more guidance as to how it should proceed to develop those proposals further. The Board could always return later to more specific modalities for the operation of such a mechanism, but at present the staff needed to know in broad terms, and as soon as possible, what the Board found acceptable in that regard. For many Fund members, debt service considerations were crucial in determining the extent to which Fund resources could be employed to help support their adjustment efforts. Thus, it would be important to have a clear sense of the possibilities that existed for assisting members in meeting Fund charges when deciding on the kind of financing packages and adjustment programs that should be put forward for the Board's consideration.

Mr. Dawson made the following statement:

The crisis in the Middle East, and the political events and economic consequences surrounding it, pose a serious challenge to the world economy and to the cooperative basis upon which the international financial structure is founded.

Clearly, the frontline states are experiencing extraordinary and unprecedented losses due to higher oil import costs and lower exports of goods and services. As we know, coordinated international efforts are well underway to address their needs. But many other countries throughout the world, though not as badly hit as the frontline states, are nevertheless seriously affected by many of these same factors.

The Interim Committee recognized this in September, and directed the Fund to respond to present difficulties on an expedited basis. As President Bush stated in his speech to the Annual Meetings: "...the IMF and World Bank--given their central roles in the world economy--are key to helping all of us through this situation by providing a combination of policy advice and financial assistance. The political leadership of the UN must be matched by the economic leadership of the IMF and World Bank."

As the central institutions for the world economy, the Fund and the World Bank must exercise leadership by adapting procedures and policies, as appropriate, to ensure a timely and flexible response. The Fund's role, in particular, will be critical, because it is the most appropriate institution for addressing the increased financing and adjustment needs of the affected countries. For the Fund to meet this challenge, it must respond, and must be seen as responding, immediately and meaningfully to the needs of its members.

We recognize that our collective effort to develop the modalities of the Fund's response will need to strike an appropriate balance between finance and adjustment, in order to safeguard the financial integrity of the Fund and strengthen countries' balance of payments prospects. In this regard, the pass-through of higher oil prices will be an essential component of the adjustment process, and individual country circumstances may warrant additional measures as well.

We must also bear in mind, however, that the oil importing developing countries face a sizeable systemic shock, and that while adjustment to higher prices will take time, the increased import bills have already started arriving. Many of these countries already face large debt burdens that constrain their ability to grow, and private markets will not play the same role as in the 1970s in recycling surpluses and meeting their financing needs. We must also not lose sight of the fact that many countries throughout the world, particularly in Eastern Europe, are engaging in bold efforts to restructure their political and economic systems away from state control toward democracy and private initiative; these countries need Fund support if their reform efforts are to stay on track.

We welcome many of the staff's proposals in the paper, but on the whole, these proposals do not go far enough. In the current circumstances, we cannot be timid. While much of the increased burden associated with the crisis in the Middle East should be addressed through appropriate adjustment measures, increased financing in response to the systemic shock must also play a significant role. It would be unrealistic to think that reliance on augmentation of access can address the political or economic dimension of the problem. Business as usual will not suffice.

Against this background, let me turn to the specific proposals in the Fund's paper.

For the seriously affected countries, the current crisis is first and foremost one of higher oil prices. If the Fund is to be seen as being responsive to members' needs, it must explicitly address the oil price problem. This institution already has a facility--the compensatory and contingency financing facility (CCFF)--that was supposedly designed to address the balance of payments problems caused by external developments largely beyond a member's control. It is hard to imagine developments that better fit the purpose of the CCFF than the impact of the crisis in the Middle East. Thus, we believe that it would be logical and appropriate to modify the CCFF so that it can be used effectively to address the adverse balance of payments impact of higher oil prices. Using the CCFF in this way would also have the advantage of providing a visible demonstration of the Fund's willingness to assist adversely affected countries--something which my authorities consider critically important in the overall response to the crisis in the Middle East.

It should come as no surprise that we are disappointed that the staff paper neither recommends including an import element in the compensatory window, nor suggests reformulating the contingency mechanism to take account of the developments that have already occurred. We have had an open mind as to whether the impact of higher oil import costs would best be handled on the compensatory or the contingency side, and we would welcome other Directors' views on this point. However, we are of a very strong view that one window or the other needs modification to address the problem of higher oil costs. On balance and after reflection, it would appear that using the compensatory window is likely to be the more satisfactory approach.

With respect to the staff's discussion of the operation of the compensatory element of the CCFF, we support the proposal to widen the definition of services, the proposals concerning the coverage of services in subsequent requests, and the proposal to lengthen the period, from six to twelve months, for which estimated data for merchandise exports may be used. Taken together, these changes will increase the accessibility of the compensatory window, ensuring that resources are more readily available to countries in need on a timely basis.

My authorities did not, however, find the staff's arguments against incorporating oil imports into the compensatory element of the CCFF to be compelling. Indeed, on the basis of the material presented and other considerations, we believe that there are strong justifications for adding an oil element to the compensatory window.

First and foremost, the seriously affected countries are facing a systemic shock caused by higher oil prices. Oil is a very special import. It is an essential item, representing a large portion of countries' import baskets, and it is one that has a very volatile price with major consequences for the balance of payments. In the short run, the demand for oil is inelastic. It is the lifeblood of the entire economy.

In this connection, information in the staff paper shows that an additional 34 out of 89 fuel-importing developing nations would have compensable shortfalls if an oil import element were added to the export shortfall calculation. Moreover, it indicates that an additional five countries would be eligible if the export projection limit were raised to 30 percent. These data highlight the gravity of the current shock and the potential usefulness of an oil element in the compensatory window.

We appreciate the staff's concerns that front-loaded compensatory financing could upset the balance between phasing and performance in Fund-supported programs. But for a number of reasons, we believe that the cause for concern has been exaggerated, and that ways exist to minimize perceived problems.

First, our work in establishing the CCFF addressed many of these concerns. During the debate leading to the establishment of the CCFF, this chair in particular argued for more tightly associating the use of compensatory financing with Fund conditionality. This was achieved.

Paragraph 12 of the CCFF decision provides for this tighter association, and, if properly applied, will ensure that the use of Fund resources is safeguarded. Furthermore, under the former compensatory financing facility, access was 83 percent of quota. Now, under the CCFF, access to compensatory financing has been reduced generally to 40 percent of quota, or to 65 percent with the optional tranche, which requires a Fund program or policies which meet upper credit tranche conditionality. As a practical matter, as noted by staff, about half of the 60 countries that could gain additional access to Fund resources if an oil element were added to the CCFF already have Fund programs, which would provide an additional framework for Fund conditionality.

Finally, the addition of an oil import element to the CCFF would not in our view be analogous to creating another oil facility. The compensatory financing would be used in association with tightened Fund conditionality, including the pass-through of higher energy costs. This would differ sharply from the experience of the 1970s.

Regarding the proposed modifications of the contingency element, we were extremely pleased by the overall impression left by the paper that the staff is now prepared to make a concerted effort to incorporate contingency planning into Fund programs. Had contingency planning been routinely incorporated in the past, we would probably not be here today debating how to modify the CCFF to take account of recent developments in the crisis in the Middle East. Nevertheless, the fact that the contingency mechanism of the CCFF has only been included twice to date, and never drawn upon, reflects at least one basic flaw in its design.

If the Board agrees that it would be appropriate to include an oil import component in the compensatory window, then I see no reason why we would need to modify the forward looking contingency mechanism to take account of developments which have already occurred, on the one hand. If, on the other hand, the Board believes that the forward looking contingency should be modified, we would certainly be willing to consider it.

The principal obstacle to more frequent use of the contingency mechanism has been, and continues to be, the symmetry provision. For example, if the staff were to include forward looking contingency elements in Fund programs based on current oil prices and the assumed baseline proved to be high, then countries would be forced to build up reserves at a time when they were already laboring to adjust to higher oil prices. I would be very surprised if many countries were willing to undertake this risk at this time. I also doubt that the international community would consider such an outcome as an acceptable response by the Fund. Yet this mechanism is supposed to be our primary instrument for dealing with contingencies.

Clearly, this is an unsatisfactory situation, and I think this fact is recognized in the staff paper. We should take this opportunity to correct this defect in the contingency mechanism in order to ensure that, following some future shock, the Fund does not find itself in the same dilemma we are facing today. Accordingly, I agree with the staff's implicit call for a fresh look at the symmetry provision, and would ask staff to provide the Board with some options on how it might be modified, with a view to making the contingency mechanism a more useful instrument for the future.

With respect to the staff's proposals for enhancing support through Fund programs, I believe that a number of important ideas have been put forward.

We support the proposal to suspend temporarily the lower-tier access limits through 1991. This would, as staff notes, underscore that the Fund's access policies are sufficiently flexible to permit access up to the upper-tier limits in appropriate cases, without recourse to the exceptional circumstances clause. Furthermore, even if access between 90 and 110 percent of quota were accorded in only a handful of cases, we believe that the temporary suspension of the lower limits through the end of 1991 would be an effective, visible symbol of the Fund's willingness to help countries deal with the economic consequences of the crisis in the Middle East.

We also support the proposed flexible approach to the use of waivers. Countries that perform in a broadly satisfactory manner and that are prepared to intensify their adjustment efforts should not have their programs derailed because of a failure to meet criteria that are no longer realistic at current oil price levels.

We were somewhat surprised, however, by the discussion on the circumstances in which the Fund would augment program resources. It appears from this that staff would prefer to rephase purchases under existing programs and to augment resources primarily in cases of expiring programs. We also noted that the staff expects uniform phasing of purchases to "remain the norm." If the norm in this context means "mode or most frequent value," I can understand. But if it implies an ideal, under present circumstances, I would not agree. Would the staff respond?

The hesitancy of this discussion appeared to me to be at odds with the tenor of the proposals to augment access contained in the Chairman's statements of September 7 and September 18. While I understand from subsequent bilateral discussions with the staff that the paragraph was not intended to limit augmentation to cases of expiring stand-by arrangements and extended arrangements (EFFs), I think this point bears clarification in the Board.

Concerning the role of the structural adjustment facility (SAF) and enhanced structural adjustment facility (ESAF), we heartily endorse the staff's intention to encourage the many members with SAF arrangements to make use of the ESAF and the opportunity to receive greater access under it. For those countries which have already entered ESAF arrangements, we support augmentation of access under ESAF programs at midterm reviews, as well as when annual programs are considered, and we welcome the additional clarifications on this point provided in the supplementary paper. We also concur with the use of fourth-year ESAF programs.

In conclusion, my authorities consider the work being undertaken at the Fund to respond to the crisis in the Middle East as one of the most important tasks facing the international economic community. I cannot overemphasize how important it is that we move ahead quickly to define the Fund's response--both to ensure that the Fund is equipped to meet the increased financing and adjustment needs of the most seriously affected countries, and also to demonstrate a unified political and economic response to the situation in the Middle East. I hope, therefore, that my colleagues on the Board will support moving in the directions I have indicated, and join with me in requesting the staff to develop proposals along these lines for the Board to consider in the very near future.

Mr. Kafka made the following statement:

The papers before us discuss a series of possibilities regarding the Fund's response to the crisis in the Middle East. They shy away, however, from the simplest, quickest, most effective and most appropriate solution: the introduction of an oil element into the compensatory part of the CCFF. This is not innovation, but only adaptation--simple and quick.

Let us, however, first define the problem. Certain countries are being heavily damaged by the increase in the oil price. Some of them are not in a position to borrow on the usual terms any significant share of their increased oil costs, because they could not repay. For those countries, concessional financing will have to be arranged. We have therefore from the outset supported the Managing Director's initiative to collect funds on a voluntary basis for subsidizing the interest cost of borrowing for certain countries, and we support his proposals to increase the amounts which can be made available under ESAF.

Other affected countries are in a position to borrow part of their increased oil burden. For them, the best form of borrowing must be found. We do not reject any of the proposals submitted by the staff, but we insist on the inclusion of an oil element in the compensatory part of the CCFF. We must not discuss the draft decisions submitted to us before a draft decision on the inclusion of an oil element has also been submitted. But I am prepared to continue to work without interruption for as long as necessary.

To avoid confusion, we want to make clear that we do not see an oil element as granting access based on a mechanical formula, but we wish to grant access based on a set of transparent criteria which are capable of uniform application. The case-by-case approach can too easily enter into conflict with uniformity of treatment. In a systemic crisis, uniformity of treatment is particularly important.

I have no problems with what the staff paper says about the overall current account effect of the crisis in the Middle East. This effect cannot be foreseen with any certainty at this moment. We feel that the Fund's liquidity will be adequate to enable our institution to make an effective contribution to alleviate the oil problem.

The staff's first set of suggestions is to provide support through Fund arrangements. The staff points to the fact that there are a large number of arrangements presently in existence which could be adapted. But there is an equally large number of countries affected by the crisis in the Middle East which do not presently have arrangements. In all these cases, arrangements would have to be negotiated from scratch. It is true that with those countries, and in the absence of a mechanical formula, understandings would have to be reached with the Fund on some mix between financing and adjustment, so that those countries could benefit from Fund drawings outside an arrangement. But such understandings need not imply, when countries are following satisfactory policies, insistence on the time-consuming negotiations of the complete panoply of performance criteria which are an essential part of Fund arrangements. Even if one does not wish to dispense with an arrangement altogether, one possibility would be to activate a CCFF oil element pending negotiation of an arrangement.

We wish, today, to comment only cursorily on the suggestions made by the staff on the adaptation of Fund arrangements, without going into any of the details which will be critical when we come to formulate decisions.

We have no objection to the suspension of the lower limits for maximum access. We do not see why this should be very helpful, except cosmetically; but neither do we see why it should be more than marginally harmful. The granting of waivers for the immediate test dates on a lapse of time basis need also not be rejected, where deviations result directly from identifiable effects of the crisis in the Middle East and measures are being adopted--including the full pass-through of oil price increases to final users--that strengthen the prospect for external viability. It is clear, however, that the qualification that I have just cited leaves the meaning of the proposed rule too uncertain to be helpful under present circumstances. We do not object to the rephasing or augmentation of access, or to the use for determining the latter of the "net sum of deviations" approach.

I have no problem with the staff's suggestions with respect to the SAF and ESAF. Specifically, we agree to the possibility, subject to the availability of resources, of increasing the total commitment of resources at the time of consideration of second- and third-year annual programs, and the possibility of providing for a fourth annual arrangement under appropriate safeguards.

We consider essential, for an effective Fund response in the present crisis management situation, the introduction of an oil import element into the compensatory part of the CCFF, to be applied, as the case may be, with or without a Fund arrangement. We would be quite satisfied if such an element could initially be introduced on the lines of the cereal import element. Insofar as the introduction of the oil element would not be the Fund's only approach to meeting the crisis in the Middle East, we are not at all impressed, on the one hand, by the fact that several of the countries most seriously affected in the Middle East would gain very little, if anything, from introduction of the oil import element. We are sufficiently impressed, on the other hand, by the fact that an export shortfall plus oil element would sharply increase--almost double--the number of countries that could have access to Fund financing, and would also sharply increase the financing which could be provided both in terms of quota and in terms of SDRs. We would also be prepared to accept an entirely separate oil element which would further increase the number of countries having access and the amount of access in terms of SDRs for countries outside the Middle East.

The other arguments advanced by the Fund staff against introduction of an oil element into the CCFF are also unconvincing. Thus, the further singling out of a specific balance of payments item for compensation should not be a source of concern where the problem is a crisis which demands an urgent response from the Fund. Nor is the fact that it is difficult to project with confidence the future path of oil prices a valid argument against the introduction of an oil element. Any assiduous reader of Fund papers knows that the future is always uncertain, and in some cases also the past. We would have no objection in adapting access so as to take account of the fact that oil prices are unlikely to fall back to the pre-August 1990 levels.

On the question of conditionality, we would have no objection to the staff's proposals for applying Paragraph 12 of the CCFF decision relating to export shortfalls, but we would think that some flexibility might need to be introduced into the requirement for prior action for countries with an unsatisfactory record.

Concerning other proposed changes in the CCFF, we have no objection, on the one hand, to the proposal of the staff regarding coverage of services in successive requests, to the adoption of a wider definition of services, or to the introduction of early drawing procedures. We think that the staff has solid grounds for excluding investment income from the possible widening of services included in coverage of the CCFF.

We have, on the other hand, no sympathy whatsoever with the staff's proposals to require from countries wishing to conclude or augment arrangements with the Fund the inclusion of a contingency element. It goes without saying that we would also object to disguised compulsion in this respect. We feel that the lack of automaticity--rather than the symmetry element--and the technical complications of the contingency element of the CCFF continue to reduce the usefulness of the contingency element in the CCFF. We, therefore, can understand that countries may see it as an obstacle to efficient negotiation rather than a helpful element. We nevertheless do not object to liberalizing the provisions regarding the occasion when the contingency element could be attached to an arrangement of a willing country. We would not find useful the introduction of a backward looking contingency element.

Finally, we would not object to a temporary shortening of the circulation period of papers supporting requests for use of Fund resources for countries seriously affected by recent developments in the Middle East.

Mr. Landau made the following statement:

Many uncertainties surround the financial impact of the crisis in the Middle East, which are reflected in the different baseline scenarios envisaged by the staff. Whatever the final outcome may be, two conclusions can be drawn from the various hypotheses laid out in the paper. First, the financial consequences of the current crisis will be substantial for many countries, at least in the short term--85 countries will be affected. What is happening clearly constitutes a systemic risk to the international community. Second, the breadth of the direct current account effect is highly sensitive to oil prices. Thus, our response should be adapted to the development of oil prices. For 1990-1991, the global effect of the oil price rise is calculated at about 64 percent to 125 percent of Fund quotas, assuming that the price of a barrel of oil is no higher than $30.

These uncertainties call for an appropriate response of the Fund, as the first task of the Fund is to help countries faced with balance of payments difficulties. In my view, we should have four considerations in mind in dealing with this question.

First, the response of the Fund should be appropriate, substantial, and prompt, in order to address the increased financial needs of the affected members. Second, in modifying our current instruments as proposed by the staff, we must be careful not to forget to consider certain categories of countries--in other words, we should make sure that no lacuna exists in our response. Third, we should ensure that our intervention is adapted in financial terms to the needs of our countries, in particular with respect to the cost of Fund resources. Fourth, we should maintain the basic principle of Fund intervention: the Fund's response alone should not address the totality of the financing needs which are required by the new situation. We have to ensure a balance between financing and adjustment in which Fund conditionality should play its regular role.

An appropriate and quick response by the Fund requires two conditions: the financial means should be substantial, and we should be able to disburse them in a timely fashion. Regarding these two conditions, the staff proposals go in the right direction. With respect to the financial means, the Fund can exercise flexibility in the framework of its existing facilities. This is all the more feasible as the Fund's liquidity appears comfortable. I have therefore no difficulties in approving the staff proposal regarding the increase or rephasing of access under the existing program when appropriate.

In the same vein, I agree with the modification proposed for SAF and ESAF arrangements. I can support the fourth year in ESAF programs along the lines proposed by the staff. Nevertheless, a greater utilization of ESAF resources will reduce the possibility of fully subsidizing the present resources, and therefore it will be important that efforts be made on this point.

Rapidity in disbursing Fund resources is certainly indispensable. Therefore, I fully support the two types of measures proposed by the staff to offer the possibility of accelerating disbursements. Those are the possibilities of modifying conditions and financing for countries with Fund-supported programs at the time of program reviews, and frontloading purchases; and the acceleration of drawing procedures from the CCFF by using estimated export data. This last point is very important, as it allows us to meet rapidly the expectations of affected countries, in particular if oil prices stay at a high level.

Greater flexibility in existing facilities, along the lines proposed by the staff, should allow addressing a significant part of the adverse consequences of the crisis in the Middle East, but it could appear insufficient to offset the sharp deterioration experienced by several countries which do not benefit from a Fund program at this time, or have reached the upper limit of the Fund's access. Thus, we strongly favor a measure considered by the staff but excluded from its formal proposals, namely, the introduction of an oil component in the compensatory window of the CCFF. This proposal was already made by Mr. Beregovoy during the Annual Meetings. Such an introduction seems to us justified by the fact that the Fund is confronted with a situation imposing both systemic and temporary risks to its members.

The risks are systemic, because an inappropriate response from the Fund could not only strongly impede the adjustment efforts undertaken by many countries in Africa or in Latin America, but could also jeopardize the transition process in

Eastern Europe. Nevertheless, we share Mr. Al Jasser's view that the present oil price increase should prove to be temporary, and that we will come back to an oil price level more in line with the fundamentals between demand and supply. That is the reason why the temporary inclusion of an oil import element in the CCFF could strengthen the Fund's response, and would be particularly well adapted for taking into consideration this systemic, but temporary, risk.

The annex of the paper shows that the introduction of an oil element in the CCFF will greatly broaden the scope of action--as many as 77 countries among the 85 countries affected, according to the staff. The tables showed that substantial amounts of funds would be available and could be mobilized very rapidly, thus offering a welcome supplementary flexibility. Finally, such a temporary mechanism could in some cases constitute a valuable substitute for increased access in Fund-supported programs, thereby avoiding the creation of a ratchet effect--namely, that augmentation in access could be considered by countries as permanent.

As to the form and precise mechanism, we have an open mind, and I would share Mr. Kafka's request for a set of transparent and uniform criteria. An oil import element could be like the cereal element, or like an isolated element. We are also open as to the level of access of such an oil element. We must explore ways to clearly define and make precise the mechanism that leads to the triggering of compensation. We certainly do not think that it is up to the Board, or to this institution, to define a right price for oil, but there is some merit to keeping in mind the baseline scenario included in the report as a starting point for compensation. However, we are open to alternatives. For example, some kind of franchise could be envisaged to remove the possibility of bias in the process, and creating the wrong incentives to drawing Fund resources. I would be pleased if the staff could study rapidly these proposals.

The idea of modifying the 20 percent export projection rule of the present CCFF has much appeal. I would however appreciate any information about the categories of countries which could benefit from such a change.

Like other speakers, we think that an exceptional Fund effort to finance these unexpected and transitory events should be accompanied by strong adjustment efforts and the maintenance of Fund conditionality. In this regard, we are reassured by the fact that many countries in a position to benefit from a new oil element in the CCFF already have a program with the Fund. Concerning other countries, although the conditionality will be reduced, Fund disbursements should not be unconditional. We should also encourage countries for which the negative consequences of the recent developments in the Middle East will be large to seek agreements with the Fund.

The problem of the cost of Fund resources remains. Something must be done to lower Fund interest rates, which are at a historically high level. In this respect, the need for some kind of concessional support is widely recognized. The real issue is whether this will take place inside or outside the Fund. The Chairman has proposed the establishment of a subsidy account, and Mr. Beregovoy expressed his support for that at the Interim Committee.

Establishing such a mechanism within the framework of the Fund would provide three assurances: first, a speedy implementation; second, a multilateral framework; and third, the maintenance of conditionality. That is why we support the Chairman's proposal.

More generally, I will support the proposed decisions, with the modifications I have mentioned.

Mr. Filosa made the following statement:

The negative effects of the Middle East crisis have already started to worsen world economic conditions. Higher worldwide inflation is clearly detectable, wider current account deficits are emerging in a number of countries, and a slowdown of real GNP is today more likely than it was only a few weeks ago. Moreover, the problems of a number of developing countries and in Eastern Europe have become more acute. It is true that in the context of the discussions on the world economic outlook, we were of the view that the situation was manageable, but it now appears that our assumptions have been, at least in the short term, perhaps optimistic. Indeed, the scenario for oil prices has been revised upward, and we cannot exclude the possibility that additional revisions might be called for.

In this context, it is important that the Fund be seen as being able to respond readily to the new situation and to extend its assistance, including financial support, to members in need. It is for these reasons that I welcome the swift move of the Management and the staff to suggest modifications and adaptations to our existing facilities to respond appropriately to the new situation.

Since I am in broad agreement with many of the staff proposals, I will limit my comments to those aspects of the proposals themselves that in my view require close attention and perhaps future work.

Regarding access, the staff proposes to suspend temporarily the lower limits through 1991, to consider augmentation and acceleration of disbursements, and the possibility of granting waivers to nonobservance of performance criteria in cases in which deviations resulted directly as a consequence of the Middle East crisis.

On the temporary suspension of the lower access limits, while I share the staff's view that such a decision would signal the Fund's flexibility to support adjustment efforts and to protect programs, I also believe that the suspension is not necessary. It is, in fact, explicit in the criteria governing access in individual cases that the balance of payments situation is, other things being equal, a crucial element in the decision concerning the level of access. It is, therefore, evident that if the oil crisis causes the balance of payments positions of member to deteriorate, then access to Fund resources will be higher than what would have been granted under normal circumstances. By suspending the lower limits, while signalling increased flexibility, we would also obscure the fact that the present criteria governing access up to the lower-limits--namely, that a member's outstanding use of Fund resources is not large, that the member has undertaken a comprehensive adjustment program, and that the Fund is satisfied with the member's past record--are still valid. Indeed, it might well happen that for some countries, access up to or below 90 percent of quota might continue to be appropriate. Also, under the present rules, the lower limits, as well as the upper limits, can be exceeded without having to invoke the exceptional circumstances clause. If the suspension of the lower limits is intended to indicate to the international community the Fund's readiness to respond to the crisis, we might well choose other, and perhaps better, instruments of communication--an explicit declaration, for example. The ability and the willingness of the Fund to respond adequately to the present situation is already in our practices and in our guidelines. However, if the majority of the Board so decides, I will not strenuously oppose the temporary suspension of the lower access limits.

I support the proposals concerning augmentation and possible acceleration of access to Fund resources. I believe that an appropriate flexibility concerning both the level and the phasing of access is the best way to deal in a timely and an effective way with the negative effects of the Middle East crisis on members' external positions. I would like to stress, however, that higher access and an accelerated disbursement should be accompanied by appropriate policy measures to address the deterioration of the balance of payments stemming from higher oil prices. Countries presently with arrangements with the Fund should strengthen their policies. The pass-through of higher world oil prices to domestic prices is only a minimum requirement. In most cases, additional fiscal and monetary measures will be necessary to justify higher access. In addition, countries which presently do not have arrangements, but which will seek in the future financial support from the Fund, in whatever form, cannot expect the Board to identify conditionality as the pass-through of oil price increases to final users.

Both augmentation and the acceleration of disbursements of Fund resources are likely to make the financing assurances problem more acute. The only way to alleviate the problem would be the introduction of adequate adjustment measures.

I can support the granting of waivers in those cases in which nonobservance of performance criteria could be related to the oil price increase. However, I cannot support the idea of granting waivers on a lapse of time basis. Waivers should continue to be granted following present procedures.

To the extent that performance criteria do not encompass the entire range of economic policies, failure to meet current account or other performance criteria would not necessarily be due to reasons beyond a member's control, such as the increase in oil prices. Even if, a priori, one can expect that in the present circumstances deviations from performance criteria could be broadly related to the Middle East crisis, individual cases need to be carefully examined and assessed in a Board discussion before a waiver is granted.

Concerning the ESAF, I have nothing to add to what my Italian authorities stated at the Annual Meetings. We support the suggestion that, on a case-by-case basis, a fourth annual arrangement under the ESAF could be approved in those cases in which past performance has been satisfactory and when additional adjustment efforts could give confidence that significant progress could be achieved.

With regard to the CCFF, we agree with the staff proposals regarding the modification of the rules concerning the inclusion or exclusion of services, the widening of the definition of eligible services, and the early drawing procedures.

Our approval of the staff proposals concerning acceleration of disbursements and augmentation under stand-by and extended arrangements and ESAF arrangements, as well as the above-mentioned modifications of the CCFF rules, indicates our strong preference for channeling additional support to countries adversely affected by the Middle East crisis through the flexible utilization of existing Fund instruments. Indeed, we believe that this is the most appropriate way to meet the needs of the countries concerned, while at the same time safeguarding the resources of this institution, and maintaining in all cases of Fund intervention an appropriate mix of financing and adjustment. On the whole, I tend to think that this approach appears to be adequate for the immediate task ahead.

I would be loathe, however, to dismiss offhand the view that the response of the Fund should address more directly the problem of meeting the members' extraordinary financing needs arising out of the Middle East crisis through the introduction of an oil element in the compensatory part of the CCFF. The idea has merit particularly if actual developments diverge significantly for the worse from the staff scenario. However, its form and modalities should be very carefully thought out in view of the dangers involved.

I would be strongly opposed to a separate cost of oil element, which would be tantamount to an oil facility. I do not think it is advisable to single out a specific balance of payments item for compensation without due regard to the overall balance of payments position, because it would weaken the ability of this institution to ensure that financing and adjustment are appropriately combined in each particular case. Adherence to this principle is all the more important since it is highly unlikely that the effects of the crisis will recede very soon, or that we are likely to return rapidly to the pre-crisis situation. Furthermore, I agree with the staff that it would not be advisable, even during a transitional peak period, for affected countries to rely mainly on financing.

For the same reasons, I am very reluctant to accept an *incremental access* for an oil element within the CCFF, or to an increase in the projected limit on export projections above 20 percent, in order to accommodate additional demands for financing on this score.

In view of these considerations, I think that we could study a modification of the CCFF that would allow the inclusion of the cost of oil imports in the calculation of the shortfall on the basis of the same principle of netting against exports that is applied in the context of the cost of cereal imports facility.

Particular attention should be paid to the conditionality that would be attached to access under an expanded CCFF. More particularly, with regard to countries coming under Paragraph 12(b) of the CCFF decision, I am concerned about the definition of the prior actions that will be required before we approve a 20 percent drawing. I cannot accept that the only prior action that would be required of countries that will become eligible for compensatory financing because of the inclusion of oil in the shortfall calculations will be the pass-through of the increased costs of oil imports to the final users. In these cases, I would think that the prior actions that we would require should go beyond oil, and include all the measures that should be taken before submission of the request, so as to provide, in the words of Paragraph 12(b)(i) of the decision, "a reasonable assurance that policies corrective of the members' balance of payments problems will be adopted". Strict adherence to this principle should be an essential prerequisite for the approval of an initial drawing. I am also concerned about the possibility provided under 12(b)(ii) and 12(b)(iii) of a member drawing up to 40 percent and 65 percent of quota even in the absence of a Fund program, if the member's current and prospective policies are such as would, in the Fund's view, meet the criteria for use of Fund resources in the upper credit tranches. These provisions have always caused me some difficulty with Paragraph 12(b) of the CCFF decision. They would give me an additional serious cause for concern if, besides, access to compensatory financing were to be allowed because of the inclusion of an oil cost excess in the shortfall calculations. I therefore believe that a staff paper on all these issues will be necessary before any final decision can be taken.

I would be prepared to consider including the cost of oil in the compensable shortfalls under the CCFF, provided that the framework of the CCFF decision as it now stands is not weakened, and that the conditionality issues are appropriately addressed.

I would agree with the staff's recommendations regarding the contingency element of the CCFF. I think, however, that modification of the symmetry provisions would be inappropriate.

Mr. Peretz made the following statement:

I agree with the Chairman's introductory remarks about the need for rapid decisions. I also agree that it is not very helpful for expectations to be built up in the press about the nature and timing of the decisions we are taking.

The Fund has an important--perhaps the key--role to play in the response of economies around the world in the wake of events in the Middle East. But in considering that response, we must not forget the lessons learned from previous sharp oil price rises. The principal lesson, which applies to developed and developing countries alike, is the need for economic adjustment. Certainly, there is often a need for temporary financial assistance to ease the adjustment process; in some countries, an acute need. But this must come alongside policy action; it is not a substitute.

In addition to national policy action, there is also a need for international action. I have in mind in particular the successful conclusion of the Uruguay Round, which for many developing countries would offer the best prospects for sustained growth.

I say that the Fund has a key role to play above all because it is uniquely well placed to provide policy advice on the correct policy response, using its seal of approval to catalyze donor support where needed alongside the Fund's own temporary financing facilities.

I therefore very much welcome the general principles set out at the beginning of the staff paper. We must not lose sight of the emphasis on a mix of financing and adjustment within the context of comprehensive adjustment programs, nor of the need to safeguard Fund resources. Moreover, we should be careful not to respond to a particular set of events with policy changes that have wider and longer-term implications for the Fund's character, or for the security of its resources. I would therefore argue that whatever policy adaptations we agree should be strictly temporary and time limited.

After taking such considerations into account, I support the emphasis in the staff paper on dealing with members' difficulties case-by-case, and, where possible, through program restructuring or augmentation.

I note that the staff's projections of Fund liquidity indicate that resource constraints should not inhibit the Fund's response. The forecast of liquidity at the end of 1991 is comfortable, at the long-term average. This is perhaps what one should expect, with some expected programs for oil exporters being postponed or reduced. Indeed, I wonder whether we might not hope for an even more comfortable position: might some gainers from higher oil prices decide to make early repurchases with the Fund? Whatever happens, however, demands on Fund resources--from Central and Eastern Europe, for example--are going to remain strong. Events in the Middle East add to the case for implementing the Ninth General Review of the Quotas as soon as possible, and I urge all members to do so.

With regard to the proposals for stand-by and extended arrangements, it is clearly right that these arrangements should be augmented, on a case-by-case basis, to take account of the impact of oil price and other developments. Depending on the other elements of the package, there might be a case for the Board giving even stronger policy guidance than contained in the paper for the staff to be flexible in negotiating access to these facilities in current circumstances.

In general, I am content with the proposal to look at what is called the net sum of deviations from a program's original baseline. Identifying these changes only for key variables reduces the danger of financing developments which result from slippages in the programs.

Such calculations, however, only give an indication of the overall package of financing and adjustment that is required, not a measure of some gap that must be filled by Fund finance. A portion of the gap will be closed by adjustment through the market and through policies. Another portion will be filled by finance from donors and creditor responses. We should remember that Fund finance is only a portion of a portion, and that the term "augmentation" applies to policies as well as financing.

Concerning the proposal to suspend the 90 percent ceiling on annual access through stand-by and extended arrangements, obviously, program augmentation will lead to some increase in the average level of access for a short period. I doubt whether the ceiling would bite in many, if any, cases, while suspending the ceiling risks generating expectations that access over 90 percent will be readily available. Nevertheless, I can see that this ceiling waiver could help give a clearly understood signal that the Fund is ready to provide extra resources in response to the crisis in the Middle East.

The proposal to allow program augmentation at midyear reviews of ESAF arrangements is, I believe, a sensible one, but in making this change, we should not weaken the conditionality associated with the generous resource provision of the ESAF. In this context, we should recognize that some members may still feel unready for ESAF and prefer to remain with the SAF.

In the past, this chair has not been in favor of fourth-year access to the ESAF. Given the circumstances in which some early entrants into ESAF are likely to find themselves as a result of higher oil prices, I can now accept such an extension, subject to certain conditions. As the paper notes, the availability of such access must not be equated with entitlement. Approval only at the end of the first three years will help. And the restriction of availability to those in such a position by November 1992 will ensure that members entering new programs cannot presume that a further year will be available. The papers before us make no reference to the level of fourth-year access; I would appreciate some comment from the staff on that.

I agree that, with some modification, the CCFF could help many members most affected by the consequences of events in the Middle East. In particular, I support the sensible proposals to introduce wider and more flexible coverage of services in the compensatory element, and to allow 12-month estimates of merchandise trade. But we should not lose sight of the basic function of the facility, which is to provide finance for temporary difficulties, carrying with it the obligation to repurchase in the event of overcompensation.

With respect to the contingency element, I accept the reasons given by the staff for not considering further the possibility of backward-looking contingency mechanisms. If retrospective insurance were available, who will want to take out an insurance policy in advance? Nor am I much attracted to the idea of modifying the symmetry provisions, which seem to me to be an essential part of the character of the facility. I am all in favor of making the mechanisms simpler, but the experience of the last review suggests this may be a forlorn hope. This is particularly unfortunate, since, in an increasingly uncertain environment, contingency mechanisms become more desirable. I therefore very much welcome the suggestion to allow the attachment of mechanisms at midterm reviews, and this certainly should be encouraged where a program is being augmented.

With respect to the interest rate subsidy account, I can only repeat the reservations I expressed at our informal discussion last week. My authorities are concerned about the risk of a shift in the character of the Fund in a direction they find disturbing. The Fund is not, and should not become, an aid institution. It is out of character for the Fund to adopt what amounts to a distortionary subsidy that will make borrowing from the Fund more attractive than other forms of finance. Principles apart, there is in any event no possibility of the UK contributing to such an account.

We would of course encourage donor support for the poorer countries adversely affected by events in the Middle East, particularly support from those countries that have made large windfall gains from those events. Such support is badly needed. We would like to see donors contribute to bring the ESAF up to its planned size. If donors wished to contribute via a new special account, I would far rather see it administered by a development institution, like the World Bank. Indeed, I understand that the World Bank will shortly be proposing a new facility to provide concessional finance to the poorer countries adversely affected by events in the Middle East.

There is a proposal by the US and other chairs for adding an oil element to the compensatory element of the CCFF. My authorities were persuaded by the staff arguments that such a proposal was unnecessary and potentially dangerous. I will not repeat the arguments. That said, if there is general support for further staff work on this idea, I would not want to stand in the way. I think there ought to be some clear ground rules for this further work, and I share the concerns expressed in some detail by Mr. Filosa in that regard. Any such oil element would need to be temporary and strictly time limited. It should lapse, at the latest, by the end of next year. It must be designed to encompass a significant degree of conditionality, and the staff should also consider the access limits very carefully. None of this will be easy--the CCFF is already very complex--and I have doubts about whether it is necessary. Would it not be possible to secure equal results by more flexible access to stand-by and extended arrangements?

I see a tradeoff between different elements of the package. Were it not for this proposal for an oil element in the compensatory facility, my authorities would have been content to accept all the proposals. I agree with what the Chairman has said about the need for a rapid response. I can support the proposed decisions concerning the ESAF, but I will have to reserve my position on the other elements of the package dealing with access to ordinary resources until we are in a position to discuss the staff's further work--if, indeed, such further work is agreed.

Mr. Al-Jasser made the following statement:

Iraq invaded Kuwait exactly three months ago today. The world has responded in concert to this breach of international peace and stability. The risks to international economic stability are considerable, requiring a commensurate response from all those concerned, unilaterally, bilaterally, or multilaterally.

Allow me to brief my colleagues about what Saudi Arabia has done in order to shield the economies of developing, as well as developed, countries from the rise in oil prices. Through coordination with other members of the Organization of the Petroleum Exporting Countries (OPEC), Saudi Arabia moved expeditiously to raise its oil output from 5.3 million barrels a day (mbd) to more than 7.5 mbd. In order to further counter the speculative upward pressures on the prices of oil, Saudi Arabia has also significantly increased its capital expenditures so as to expand its oil production capacity. Investments in this sector during 1990/91 will be about $4.7 billion. My authorities are determined to do their utmost to ensure adequate supplies of oil at reasonable prices. Clearly, this is the most significant contribution to world economic stability during these trying times.

Saudi Arabia is in the eye of the storm. It is incurring tremendous costs to beef up its defense and security forces, accommodate the more than 300,000 Kuwaitis escaping the occupation, as well as supporting the multinational forces deployed in the country. Nevertheless, and despite its budgetary difficulties, it has committed more than $4.0 billion in aid to the frontline states, and those severely affected by the crisis and critical to the international efforts to contain the Iraqi aggression. More than $2.0 billion of that amount has already been disbursed. The consequence of all these additional costs is that Saudi Arabia's budget deficit for this fiscal year is expected to be higher than forecasted before the crisis, but Saudi Arabia cannot afford not to act responsibly under such a crisis situation.

This being said, I welcome this opportunity to discuss the response of the Fund in the wake of the recent developments in the Middle East, as I believe that the Fund should take a leading role in assisting those members which are in need of help. I would also like to thank the staff for their efforts in preparing the difficult paper before us. Indeed, I fully endorse the approach of the paper, which attempts to tackle the temporary difficulties emanating from the crisis in the Middle East through the flexible use of existing Fund arrangements. However, the Fund's response to the current difficulties must remain anchored by the necessity to pay due consideration to balance of payments need, the strength of the adjustment effort, and the capacity to repay.

With this in mind, I can go along with the suggestions concerning the granting of waivers and rephasing the purchases on a case-by-case basis. Regarding the temporary suspension of the lower access limits, while I have no strong reservations against this proposal, I believe that the crucial issue is that of actual access. Indeed, there appears to be room to increase such access at this stage. In addition, the use of the net sum of deviations approach to augment existing arrangements may be helpful in some cases. However, in such cases, particular attention will need to be given to an appropriate mix of financing and adjustment, and a member's capacity to repay the Fund.

Turning to the use of the SAF and ESAF, I endorse the staff view that envisages an increase in actual access during second- and third-year arrangements, along with the augmentations of an annual arrangement at the midterm review, in line with the net sum of deviations approach. Moreover, consideration of a fourth-year annual arrangement seems even more appropriate at this juncture, although I would not want it to be viewed as an entitlement.

With respect to the CCFF, it is appropriate to widen the definition of services to include receipts from pipelines, canals, shipping, transportation, construction and insurance. I can also go along with the proposal that the exclusion of services in the calculation of the shortfall should not prevent their subsequent inclusion, which, in turn, would become mandatory for a period of three years. However, while I can support the proposal to prolong the period for which estimated data of merchandise exports can be used from six to twelve months, it is important to take account of the possibility of overcompensation, particularly when one considers the potential to redirect trade within a twelve month period.

The final and most difficult issue under discussion is the treatment of oil import excesses. Here, I would have no problem in supporting the introduction of an oil import element in the CCFF, so as to determine an overall balance of payments shortfall along the lines of the cereal facility. However, I also have sympathy with the staff proposals. The staff's argument against singling out a specific balance of payments item for compensation is interesting. Perhaps the staff could elaborate on this, as well as on the problems involved in the determination of a shortfall, and the difficulties in attempting to isolate this factor in certain instances. In this connection, I would be interested to learn which approach would lead to the most expeditious response by the Fund.

The crucial issue is that the Fund expeditiously handle the increased needs of its members irrespective of the particular conduit through which its support is channeled. Consequently, I could support either the staff proposal or the import element, both of which could be considered complements, rather than substitutes. Regarding the use of contingency mechanisms, I would have reservations if the feature of symmetry is tampered with.

On the subsidy account, my colleagues are aware of my views on this from our informal meeting. Hence, I do not need to repeat my arguments, but it suffices to reiterate that the subsidy account can, in principle, detract from the monetary character of the Fund. As also noted by Mr. Evans, we should keep issues of aid and Fund financing separate. In addition, I believe that there is a more hazardous issue here. Are we prepared to consider a subsidy scheme for every temporary shock that this institution may be faced with? Such an approach could undermine not only the monetary character of the Fund, but also the underpinnings of facilities, such as the CCFF. Therefore, the Fund should adhere to its catalytic role. To the extent that Fund lending acts as a catalyst to generate parallel financing on concessional terms, an implicit subsidy will be assured. Saudi Arabia is already doing so on a bilateral basis.

Mr. Clark made the following statement:

We recognize the very serious impact that the crisis in the Middle East will have on the balance of payments and growth prospects for a number of low and lower-middle income countries, and welcome the opportunity to address the Fund's proposed response.

In our view, the most important prerequisite for a successful adjustment by those countries affected by recent events in the Middle East will be a speedy adoption of appropriate monetary, fiscal and exchange rate policies. In this context, the Fund is well placed to play an important supportive role in facilitating this process, through the provision of both policy advice and financial resources. I would also note that the responsibility to adjust policies is also shared by the industrial countries, especially those suffering from domestic imbalances. In the present circumstances, the adoption of sound macroeconomic policies by the major industrial countries can play an important role in alleviating the burden on less advantaged members, through an increase in global savings and a reduction in interest costs.

We support the broad principle of adapting existing instruments of the Fund. However, in our view, this process should be consistent with the Fund's role, as defined by the Articles of Agreement, to "give confidence to members by making the general resources of the Fund temporarily available under appropriate safeguards." The Fund's response should continue to be guided by balance of payments need, the strength of adjustment programs, and the capacity to repay the Fund.

In commenting on the proposals, I will first address the proposals set out in the Fund paper, and then make a few comments on the proposed interest subsidy account. Regarding the former paper, we are in broad agreement with the strategy that underlies most of the proposals.

We agree with the staff that, with respect to stand-by and extended arrangements, existing policies on access and phasing provide adequate scope for a flexible Fund response, on a case-by-case basis. However, we would not agree with the suggestion that waivers could be granted on a lapse of time basis for the most immediate test date. This could give the impression that the Fund is pursuing an across-the-board, rather than a case-by-case, approach. Moreover, Board discussion would likely be brief, and waivers granted, if it were clear that deviations from performance targets resulted from the effects of the oil situation and that appropriate policy measures were being taken.

We would also support the possible rephasing of purchases, through an accelerated provision of resources. However, we feel that such rephasing should be accompanied by significant prior policy action.

We could also support the proposed temporary suspension of the lower access limits, although we are unable to understand exactly why this action is necessary. First, access under existing programs is, except in one instance, substantially below 90 percent. Second, under current guidelines, access in the 90 percent to 110 percent range is already available, provided that balance of payments problems are severe and temporary.

We are in broad agreement with the staff proposals regarding the SAF and ESAF. In particular, we could support the proposed extension of ESAF to a fourth year, the possibility of augmentation at the time of the midyear review, as well as the acceleration of disbursements.

However, there is an issue that the staff may wish to comment on. We would be concerned that the extension of the ESAF to a fourth year could lead to delayed adjustment. Therefore, we wonder whether such an extension should not be predicated on members' willingness to meet original program targets, as well as their willingness to make additional efforts.

With respect to the proposed amendments to the CCFF, we can support, in principle, the proposals to widen the definition of services and to lengthen the period over which estimated export data may be used to calculate shortfalls. However, this should not come at the expense of the staff's ability to assure the adequacy of the data.

We can also support the proposal to temporarily suspend the prohibition on inclusion of services in the calculation of export shortfalls for those countries that had opted to exclude them under previous arrangements. However, we are uncomfortable that the proposal also would permit countries to exclude services which had been previously included. This would seem to encourage members to manipulate the data, rather than adopt a wider definition of export shortfalls. For the same reason, we also feel that a reduction in the period over which such decisions should remain in effect would be inappropriate.

We agree that a concerted effort should be made to include contingency mechanisms in Fund-supported programs. However, we do not favor weakening the symmetry provisions of the current facility simply to encourage its use.

We were in agreement with the staff that it would not be appropriate at this time to include an oil import element in the CCFF, since we feel that the Fund's response should primarily be in the context of conditionality under a Fund-supported program. Nonetheless, we would be prepared to accept the U.S. proposal, once the details are available. In particular, like others, we would be interested to know more fully how the issues of access and conditionality will be addressed. For example, the U.S. proposal could be seen to substitute for the staff's suggestions for augmentation and access for stand-by and extended arrangements. In general, however, we feel that the Fund's response should be in the context of an integrated and consistent package of measures. Therefore, like Mr. Peretz, until all the components are specified, our acceptance of those elements before us today, especially those relating to the stand-by and extended arrangements, has to be qualified.

We do not support reducing the circulation period for Board papers requesting use of Fund resources by members adversely affected by the crisis in the Middle East. Reducing the period would adversely affect the ability of our authorities to review Board documents, especially because when the Board agenda is crowded, the circulation period comes to represent an upper, rather than lower, bound.

The proposal for an interest subsidy account would represent a significant deviation from the monetary character of the Fund. The proposal is, in effect, an aid program, representing a substantial resource transfer of as much as SDR 1.5 billion. While a transfer of this magnitude may be appropriate, we are not convinced that its delivery should be through the blanket provision of low interest rate loans by the Fund. Given the range of per capita income levels to which such subsidies would apply, the proposal would seem to be severely regressive. In our view, other bilateral and multilateral mechanisms and agencies are better equipped to efficiently allocate such aid resources.

Moreover, we are unconvinced that interest subsidies are a necessary response to the present situation. As is noted, the subsidy would be largely symbolic. However, the Fund's rate of charge, as well as the relatively short term to maturity of Fund credit, play a key role in ensuring that member countries appropriately allocate the Fund's scarce resources. Subsidizing access in the manner and to the extent suggested would tend to distort the tradeoffs between borrowing and macroeconomic adjustment, and could discourage, rather than encourage, sound policy choices.

Mr. Mirakhor made the following statement:

This chair would like to thank the staff for this timely paper, which was produced in response to the Interim Committee's request that the Fund explore ways and means of responding in an expeditious manner to assist the developing countries that have been seriously affected by recent developments in the Middle East. While we fully share the concern of these countries as reflected in the G-24 communiqué of September 1990, it is worth noting that the crisis has also affected many oil exporting countries, particularly those near the area of the tension. The massive military buildup in the region has imposed additional costs on these countries in terms of necessary precautionary defensive measures, as well as the costs involved in the settlement of refugees. In the case of one member of our constituency, for example, the settlement of refugees has disrupted reconstruction efforts in many provinces, and additional costs have been imposed on the country in terms of loss of workers' remittances and reabsorption of migrant workers.

The staff suggests that the Fund could respond expeditiously to the needs of individual members by adapting its existing policies regarding use of Fund resources under stand-by and extended arrangements, the enhanced structural adjustment facility, and the compensatory and contingency financing facility. While we concur with the overall approach taken by the paper--particularly the proposal to help ESAF eligible countries--it must be emphasized that the effects of the crisis on the current account cannot be meaningfully quantified without taking a dynamic view of the impact on growth, employment, prices, consumption and even the social and political balance of the society. A static view of the current account impact for all countries in general, and for less developed oil importing countries in particular, does not help in the process of focusing on the main issue, that is, a further crippling of these economies, the need for growth and employment generation in those countries, and the financial constraints on effecting growth and employment in them.

There is an explicit suggestion in the paper that the increase in oil prices should be reflected promptly and fully in increased domestic oil prices in these countries. It is also suggested that any additional financial assistance be linked to stronger adjustment efforts. These suggestions raise several issues.

First, given the volatility of the world oil market, and the thin margin of capacity of many developing countries to absorb the severe economic, social and political consequences of a full price pass-through, it would seem advisable to allow the world oil market to achieve some measure of stability before requiring the countries to adjust. The pricing mechanism that prevails in most of the developing countries is not similar to that prevailing in industrial countries.

Second, unlike in developed economies, major components of oil imports in developing countries are used, inter alia, for production and for sustenance of the poor in home heating, public transportation, and electricity generation. Therefore, oil imports in these countries are more directly related to employment and the maintenance of the standard of living of the economically weaker classes than in the developed countries. Consequently, a full price pass-through will have much wider ramifications for such countries than would be the case where the bulk of the demand for oil emanates directly from the consumption sector.

Third, should oil prices fall, will there be a symmetrical recommendation for a price pass-through in the downward direction? And if so, what would the oil price volatility do to adjustment and growth of these economies? In this regard, we note that the staff is not proposing at this time the introduction of an oil import element into the compensatory financing facility. While we understand why one should not single out a particular commodity, especially when similarly strong sentiments do not apply symmetrically to oil export shortfalls and we would have preferred that the import component encompass all major imports, given the urgency of the problem at hand, we feel that the introduction of an oil import element is on balance warranted.

Fourth, careful consideration should be given to what constitutes an appropriate mix of adjustment and financing in the present circumstances. Clearly, countries that were unable to enter into arrangements with the Fund, and those that had difficulties in meeting performance criteria prior to the present crisis, are likely to experience even greater hardship in meeting the criteria for new or continued assistance from the Fund.

Notwithstanding the above issues, we find the proposed technical modifications and changes to the present Fund facilities, including the compensatory and contingency financing facility, acceptable.

We support the amendment to paragraph 13 of the CCFF decision which would make only the option to include services binding for a period of three years. Thus, a member making a purchase only on the basis of an export shortfall would be free, at any time, to include services in any subsequent purchase. While we can also go along with the proposal to adopt a wider definition of services, the statistics must be available in a timely manner, and the staff must be satisfied that the statistics are reasonably accurate. While we are cognizant of an increase in the risk of overcompensation, we can also support the staff's proposal to lengthen the period for which estimated data on merchandise exports may be used for up to 12 months.

With respect to the contingency element of the CCFF, it is disappointing to note that contingency mechanisms have only been attached to arrangements with two members--Trinidad and Tobago, and the Philippines. The idea of a contingency mechanism as an insurance policy for programs is a relatively simple one. Translating this simple idea into an operational mechanism, however, seems to have made it quite complex. Hence, in addition to examining possible modifications to the symmetry provisions, consideration should also be given to simplifying and condensing the operational guides on the CCFF to make them more useful to the staff in Area Departments and to the authorities in the members countries.

For all these considerations, we cannot support the proposal to attach contingency mechanisms to those programs developed in response to the crisis in the Middle East. We believe that Fund support to these countries should be expedited and not be hampered by the complexities of the contingency element of the CCFF.

When all is said and done, the proposed amendments to the existing Fund procedures and access limits will not make the program more accessible to those who need it most, unless the program is supported by additional resources, along the lines of what the Chairman has recommended, in order to reduce the cost of Fund charges. Financial support has to be broad based, with the participation by all members in a position to make a contribution. On the one hand, many of the net oil exporters are struggling to recover from the devastating effects of the shock to their economies resulting from the massive oil price declines of the 1980s. Even so, some of them have already responded positively to the Chairman's proposal. The industrial economies, on the other hand, experienced substantial growth during the second half of the 1980s from the fall in oil and nonfuel commodity prices. According to the world economic outlook reports, in one year alone--1986--the reduction in oil and nonoil commodity prices brought about terms of trade gains of some $115 billion to the economies of the major industrial countries. This income gain was equivalent to about 1 1/4 percent of their combined GNP. This terms of trade gain allowed the industrial countries to strengthen their aggregate current account position to the tune of $46 billion in 1986.

The estimated amount of SDR 3-4 billion to support the subsidy account constitutes less than 5 percent of the total terms of trade gain from oil and nonoil commodity price declines in 1986 alone. Even if the industrial countries were to fully support the subsidy account all on their own, their contribution would amount to a small fraction of their combined terms of trade gain from the fuel and nonfuel commodity price decline of the last half of the 1980s.

Mr. Torres made the following statement:

We welcome the proposals put forth by the staff to introduce additional flexibility into the existing Fund facilities in order to support its members in difficult balance of payments situations. We are also very pleased with the speed with which the Fund is reacting to present problems. Very likely, the intense Board discussions during the reviews of Fund facilities in the recent past have also been helpful to this swift reaction. We have needed a Middle East crisis to increase the possibilities of reaching a consensus on the need to adapt and add flexibility to some aspects of Fund facilities. The effectiveness of the proposed measures is still uncertain and will be determined in the months to come. However, we hope that the experience with the new modalities will prove successful and may help us to introduce lasting improvements in the functioning of Fund facilities.

Both the staff and the Interim Committee believe that the Fund is well equipped to adapt to the new situation and to help members face the crisis, that the lessons of previous disruptions in oil markets should help to implement sound policy reactions to present troubles, and that the ongoing programs with the Fund and other international financial institutions with many of the severely affected countries will facilitate the necessary process of adjustment.

This approach is faithfully reflected in the proposals that are on the table today, in, for example, the proposal to suspend temporarily the lower potential access limit to Fund resources, which, I think, intends to give confidence to member countries facing severe financing problems that the Fund's attitude will be more flexible. It is a step in the right direction, but I am not sure it is enough.

Will this change in access policy be effective in fulfilling its intended purpose? To answer this question one needs to look at the figures presented in the background note on the enlarged Access policy and access in individual cases and to table 2 of EBS/90/179, which indicate that the potential access limits have not been a binding constraint in most countries using Fund resources. The binding constraint has been the criteria by which effective access is determined, namely, the capacity to repay. Certainly, the crisis in the Middle East has increased the balance of payments financing needs, and will surely imply an intensification of adjustment efforts, but unfortunately it will also bring about a deterioration in repayment capacity. Therefore, at this juncture, we should not oversell the scope of the proposals that we are discussing today, and we may need to discuss additional, more decisive and imaginative, actions to confront the current crisis, with--obviously--the necessary respect given to the prudent application of effective access to Fund resources.

In this regard, we believe that Mr. Dawson's proposal to include an oil import element in the CCFF merits serious consideration. Such a window would give access to compensatory financing to an important number of countries. Compensatory financing is one of the most expeditious facilities; therefore, widening its coverage would further the goals set forth by the Interim Committee to act expeditiously and effectively. The establishment of such a window would be a very good complement to the other proposals set forth by the staff. We consider it very important that the whole package of measures be decided upon simultaneously, therefore we support Mr. Kafka's suggestion to defer the approval of the proposed decisions until we have before us a complete package.

We welcome the staff's attitude toward introducing greater flexibility to Fund facilities. However, we would like the guidelines to be as clear as possible in order to signal as clearly as possible to the affected countries the degree of support that they can expect from our institution.

Mr. Goos stated that there was little doubt that recent developments in the Middle East had caused severe economic and social strains for quite a number of countries, and that the international community was called upon to assist those countries to persevere in their adjustment efforts. Those adjustment efforts were now more important than ever under the more difficult external environment. He would agree that the Fund had to make its contribution within its mandate of a monetary institution. The Interim Committee's conclusions on the matter of the Fund's response to the recent developments in the Middle East remained valid--that the Fund is basically well equipped to help members overcome the adverse effects arising from the crisis in the Middle East, and that the Fund should respond expeditiously through use of existing instruments and the adaptation of those instruments, as appropriate. At the same time, he believed that the Interim Committee had also considered that such adaptations must not compromise the basic principles of Fund policy, the soundness of its liquidity position, or its financial integrity.

The critical principles of Fund policy included, first and foremost, the requirements that access to the Fund's resources be based on balance of payments need, the strength of the adjustment effort, and the capacity of members to repay the Fund, Mr. Goos recalled. Moreover, in keeping with its catalytic role, the Fund could not be expected to fully, or even largely, meet the additional financing needs resulting from the crisis in the Middle East. In that respect, he fully agreed with Mr. Peretz.

In assessing the various options for the Fund's response, it would be critical not to set the tracks in a direction that would undermine the

He was not certain what the staff had in mind with respect to possible improvements in the symmetry provisions, Mr. Goos stated. At any rate, he believed that the substance of the symmetry provisions should be maintained.

Finally, he continued to believe that it would be inappropriate to establish an interest subsidy account in the Fund, Mr. Goos concluded. Rather than going into the details, he would simply like to associate himself with the arguments that had been made in that connection by Mr. Peretz, Mr. Clark, and some other chairs.

Mr. Arora made the following statement:

> Let me compliment the staff for the excellent paper on the response of the Fund in the wake of recent developments in the Middle East. The reasons for praising the quality of the staff's work will become clear as I develop my argument, but acknowledgment of the useful, constructive, and--may I venture to say--sympathetic effort had better be made straightaway. We owe a great deal to the initiatives taken by the management and to the Governors of the Fund who have encouraged us to deal with the problems caused by recent developments in the only way they can be dealt with, namely, by an appropriate mix of adjustment and financing.
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> The staff had to work under serious limitations. First, we judged that the matter had no major systemic implications--a conclusion that the staff has reproduced in the first paragraph of the paper. Therefore, no major initiative was justified. We could really get along very well with whatever instruments we already had at our disposal. But, second, we felt that notwithstanding the marginal impact which oil market developments would have on the world economy at large, we had nevertheless to consider the problems of a large number of countries which have been out in the cold for a fair amount of time. Their condition was bound to worsen, even though temporarily, for by the last quarter of 1991 oil prices are likely to move into a trajectory consistent with the stable and sustainable growth of the world economy. These two considerations dictated that we should walk, carefully and cautiously, on the razor's edge--doing neither too much nor too little in any direction. We wanted a delicately crafted balance. Let us see if we have achieved it.
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> Analytically, the problem the staff is trying to address is how to increase access. A related, and equally important, issue is how to do it expeditiously and with utmost flexibility. The broad approach was set out in the Chairman's comments of September 7, 1990. The staff paper follows it closely, except in oneimportant respect, to which I will return shortly. I

In this regard, we believe that Mr. Dawson's proposal to include an oil import element in the CCFF merits serious consideration. Such a window would give access to compensatory financing to an important number of countries. Compensatory financing is one of the most expeditious facilities; therefore, widening its coverage would further the goals set forth by the Interim Committee to act expeditiously and effectively. The establishment of such a window would be a very good complement to the other proposals set forth by the staff. We consider it very important that the whole package of measures be decided upon simultaneously, therefore we support Mr. Kafka's suggestion to defer the approval of the proposed decisions until we have before us a complete package.

We welcome the staff's attitude toward introducing greater flexibility to Fund facilities. However, we would like the guidelines to be as clear as possible in order to signal as clearly as possible to the affected countries the degree of support that they can expect from our institution.

Mr. Goos stated that there was little doubt that recent developments in the Middle East had caused severe economic and social strains for quite a number of countries, and that the international community was called upon to assist those countries to persevere in their adjustment efforts. Those adjustment efforts were now more important than ever under the more difficult external environment. He would agree that the Fund had to make its contribution within its mandate of a monetary institution. The Interim Committee's conclusions on the matter of the Fund's response to the recent developments in the Middle East remained valid--that the Fund is basically well equipped to help members overcome the adverse effects arising from the crisis in the Middle East, and that the Fund should respond expeditiously through use of existing instruments and the adaptation of those instruments, as appropriate. At the same time, he believed that the Interim Committee had also considered that such adaptations must not compromise the basic principles of Fund policy, the soundness of its liquidity position, or its financial integrity.

The critical principles of Fund policy included, first and foremost, the requirements that access to the Fund's resources be based on balance of payments need, the strength of the adjustment effort, and the capacity of members to repay the Fund, Mr. Goos recalled. Moreover, in keeping with its catalytic role, the Fund could not be expected to fully, or even largely, meet the additional financing needs resulting from the crisis in the Middle East. In that respect, he fully agreed with Mr. Peretz.

In assessing the various options for the Fund's response, it would be critical not to set the tracks in a direction that would undermine the ability of the Fund as a monetary institution to effectively assist its membership in the longer run, Mr. Goos pointed out.

He could endorse the staff's conclusions on the Fund's liquidity position presented in the paper on that subject, including the warnings about the particular uncertainties surrounding the liquidity projections, and the staff's call on members to implement the quota increase without delay, Mr. Goos noted.

Against the background of those general considerations, Mr. Goos continued, he could endorse the staff proposals concerning stand-by and extended arrangements, although, like Mr. Filosa and others, he would have preferred to leave the access limits under the enlarged access policy unchanged. Considering that the Fund was expected to deal with specific problems affecting a limited number of members, a general relaxation of access would appear inappropriate and, indeed, unnecessary. Access in the range of 90 to 110 percent of quotas was presently limited to adjustment programs which, inter alia, would yield quick, sufficient, and durable improvements in the balance of payments; he would have thought that that was exactly what the Fund should strive for under the present circumstances. That aside, it appeared doubtful that a suspended sublimit could be reinstated later on without encountering substantial resistance.

Concerning the SAF and ESAF, his authorities could not support the proposal to introduce a fourth-year annual arrangement under the ESAF, Mr. Goos went on. The ESAF had been established as a one-time, temporary operation, and he feared that a fourth-year arrangement might pave the way toward a permanent facility. Moreover, his authorities were concerned that the proposal would lead to an unwarranted concentration of ESAF lending to a relatively small number of members--a consequence which would be in the interest of neither the ESAF-eligible countries nor the ESAF creditors.

He had been prepared originally to support the proposal on access to the ESAF as outlined in the staff paper, but after having read the supplement to it, he had become somewhat confused about it, Mr. Goos commented. In the main paper, he had had the impression that the existing guidelines for access would not be changed, whereas in the supplement paper, it was clearly stated that the overall financing framework could be increased on the occasion of midterm reviews. Provided that the latter interpretation was correct, his authorities regretted that they could not support such an adaptation, for about the same reasons that they could not support introducing a fourth annual ESAF arrangement. More generally, his authorities hoped that the proposals concerning the ESAF would be implemented without violating the agreed principle that ESAF lending, on average, would not exceed 150 percent of quota. They would welcome the staff's confirmation of that principle.

He could go along with the thrust of the staff proposals regarding the CCFF, Mr. Goos continued, although in doing so, he shared the staff's concerns about the possible introduction of an oil import element into the compensatory part of the CCFF. Such an approach would indeed be tantamount to establishing a separate oil facility, and the singling out of a further specific balance of payments item for financing. Accordingly, he was not sure to what extent the proposal would be consistent with the Interim Committee's call merely to adapt existing instruments, and with the general principle that the Fund would address balance of payments problems in a comprehensive way. Moreover--and he knew that he was in disagreement with other speakers in that regard--he would also side with the staff when they referred to the likelihood that technical problems would arise in operating such an oil window, given the fact that in present circumstances future oil price developments--namely, oil price developments in the postshortfall years--would be anything but predictable. At any rate, if there should be a majority in the Board to pursue that idea further, appropriate precautions should be taken to assure a sufficient degree of conditionality, and also steps to protect the financial integrity of the Fund. In that regard, he found himself in full agreement with the observations of Mr. Peretz and Mr. Filosa. He was also not fully convinced by Mr. Dawson's argument that a separate oil window was needed in order to give clear, visible signals of the Fund's willingness to assist affected members. The same signal could be provided on the basis of the staff proposals, in particular inasmuch as it was envisaged that oil import costs would be mentioned explicitly in determining access and augmentation.

He could go along with the proposals concerning the inclusion of a wider range of services, and also the early drawing procedures, but those modifications to the compensatory element of the CCFF should not be made permanent, but rather subject to a review at the end of 1991 or beginning of 1992, Mr. Goos noted.

The proposal of a concerted effort to introduce contingency planning in programs brought back concerns he and others had expressed at the time of the introduction of the CCFF, Mr. Goos pointed out. Consistent with those concerns, it was of paramount importance that the wider use of contingency mechanisms did not weaken either the design of the underlying programs or members' resolve to pursue vigorously their adjustment targets.

He was convinced of neither the usefulness nor the need of allowing contingency mechanisms under the CCFF to be attached at the time of midterm reviews, Mr. Goos continued. At such a late date in the program period, the contingencies should normally be identifiable with a reasonable degree of accuracy, and, hence, it should be possible to provide for adequate safety margins in the formulation of adjustment policies at midterm reviews.

He was not certain what the staff had in mind with respect to possible improvements in the symmetry provisions, Mr. Goos stated. At any rate, he believed that the substance of the symmetry provisions should be maintained.

Finally, he continued to believe that it would be inappropriate to establish an interest subsidy account in the Fund, Mr. Goos concluded. Rather than going into the details, he would simply like to associate himself with the arguments that had been made in that connection by Mr. Peretz, Mr. Clark, and some other chairs.

Mr. Arora made the following statement:

> Let me compliment the staff for the excellent paper on the response of the Fund in the wake of recent developments in the Middle East. The reasons for praising the quality of the staff's work will become clear as I develop my argument, but acknowledgment of the useful, constructive, and--may I venture to say--sympathetic effort had better be made straightaway. We owe a great deal to the initiatives taken by the management and to the Governors of the Fund who have encouraged us to deal with the problems caused by recent developments in the only way they can be dealt with, namely, by an appropriate mix of adjustment and financing.
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> The staff had to work under serious limitations. First, we judged that the matter had no major systemic implications--a conclusion that the staff has reproduced in the first paragraph of the paper. Therefore, no major initiative was justified. We could really get along very well with whatever instruments we already had at our disposal. But, second, we felt that notwithstanding the marginal impact which oil market developments would have on the world economy at large, we had nevertheless to consider the problems of a large number of countries which have been out in the cold for a fair amount of time. Their condition was bound to worsen, even though temporarily, for by the last quarter of 1991 oil prices are likely to move into a trajectory consistent with the stable and sustainable growth of the world economy. These two considerations dictated that we should walk, carefully and cautiously, on the razor's edge--doing neither too much nor too little in any direction. We wanted a delicately crafted balance. Let us see if we have achieved it.
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welcome the procedural simplifications and modifications suggested by the staff in regard to stand-by and extended arrangements. I believe that they could provide effective and expeditious assistance to member countries, especially to those countries that have existing Fund-supported programs. Average annual access in existing arrangements is still quite low and could be quickly increased, provided that the Board permits--and, indeed, mandates--an attitudinal change on the part of the staff. In fact, the changes suggested by the staff, desirable and necessary as they are at this juncture, would be of no avail if the inhibitions of the recent past continue to guide actual practice. Surely we would not wish to lift restrictions in theory, only to see them reimposed in practice in so many subtle and not so subtle ways. The "buzz words" here--catalytic, the strength of the adjustment program, exposure, the capacity to repay--all very important concepts endorsed by the entire membership, need appropriate interpretation in the new context of the looming liquidity crunch for a large number of low-income oil importing countries. In a crisis situation, a decathlon competition, however invigorating in more agreeable circumstances, will not help the patient; most would feel a lot better simply with the means to walk on two legs.

I support the staff proposals in regard to the SAF and ESAF. I am particularly happy to see the proposal for a fourth-year ESAF program. In my view, it is a right response to the critical situation confronting a large number of SAF- and ESAF-eligible countries.

The modifications suggested in respect of the CCFF are, on the whole, helpful. One wonders whether on the strength of these changes more effective use of the CCFF will begin to be made; we have to wait and see. Once again, it is not so much the letter of the law, but more the spirit in which the law is implemented. As Mr. Kafka has on several occasions pointed out, the 1983 guidelines have not always been applied correctly. The test of cooperation with the Fund has invariably been assumed to be a Fund-supported program, whereas in fact there was no such intention. The 1988 decision did not clear the air. As a result, the CCFF, with a history going back to early 1960s, has not been of much help to the membership. I hope that, in an environment of enhanced vulnerability, the CCFF will come into its own and make a positive contribution to the adjustment process.

I have dwelt at some length on the brighter elements of the picture. It was necessary to do so to emphasize that the Fund, as a pivotal institution of the international monetary system, intends to play its rightful role in assisting its poorer members, who have to deal with an extremely serious problems. There are, however, some missing elements to which attention must be drawn. In my view, these missing elements have detracted from the balance that the staff had endeavored to create.

Before I describe the vital absences, it may be well to spend a little bit of time reflecting on the CFF and its later incarnation. It is not my intention to delve into the successive stages of the evolution of the CFF; I would just like to focus on basic aspects of the interaction of the Fund with the wider world environment. The 1960s and 1970s, when the CFF took shape, were what used to be called the age of rising expectations, or the revolution of rising expectations. The Fund interacted with the United Nations and with UNCTAD, and each episode in the history of the CFF was a significant episode of liberalization in terms of access and in terms of the structure of the facility. It is important to remember that the facility, vastly improved since its inception in 1963, addressed a serious problem faced by developing countries, the problem of precipitate declines of commodity prices set against a secular trend of a decline in real prices of primary commodities. And although the facility fell short of the expectations of developing countries, the creative nature of the Fund's response over more than two decades cannot be underestimated. In contrast to the 1960s and the 1970s, the 1980s were, in Paul Krugman's phrase, "the age of diminished expectations." The phrase refers to a different universe of discourse, but it captures in some way our own predicament. Actions which in another time would have appeared inadequate now come to be seen as nothing short of heroic. Since we do not expect much to happen, when some little bit does happen, it hits us with the force of a revelation. Thus, it was not entirely a coincidence that the CFF should have been given a narrower interpretation and heightened conditionality precisely at a time when the emergence of the debt crisis warranted greater stress on the original elements of automaticity and simplicity that truly defined the CFF. While we applaud today the modifications suggested by the staff, in comparison to the now crumbling architecture of the old CFF, they cannot be described as a meaningful restoration work.

From this perspective, the omission of the oil import element from the compensatory facility and the pronounced lack of progress on the proposal for establishing a temporary subsidy account give signals of ambivalence, not of clarity of purpose and direction. My grateful thanks are due to Mr. Dawson, who has rescued the oil import element from the oblivion to which it had been consigned. In a way, it is reminiscent of the initiative taken by the U.S. in 1975 to carry out some major modifications in the CFF. I do not wish to repeat the arguments so ably made by Mr. Dawson and Mr. Kafka to answer the doubts raised by the staff. In the context of the present situation, a CCFF without the oil import element is like playing Hamlet without the Prince of Denmark. I have no doubt that the staff mean well when it said that it is difficult to make the oil import element work satisfactorily within the constraints imposed by the present structure of the CFF. That is a point well taken. Given this problem, what should have our response been? Should it have been to say, as the staff did, to leave the CFF well alone, and move on to improve access in other ways? Or should it have been to say, to improve access in other ways is not the same thing as improving the structure of the CFF, because the CFF serves a different purpose, and it should, in its own right, be made a more effective instrument, along with the other instruments of the Fund? The second response was the preferred response of the Fund in the earlier episodes of reform of the CFF. It is to this original vision that we must return. The Managing Director had authored this idea in his statement of September 7, 1990. Subsequently, the practical difficulties of incorporating it into the existing structure of the CFF prevailed, and the idea was reluctantly given up. The discussion this morning opens up the possibility of reconsideration on the basis of carefully worked out options.

I need hardly stress the importance of a temporary subsidy account for low-income countries. The proposal made in the Managing Director's note of October 18, 1990 deserves strong support. It is a quintessential expression of the age of reform. As the Managing Director has pointed out, it is not incompatible with the monetary character of the Fund. Let me emphasize that market related rates of interest are not the sole attribute of this institution; there are other characteristics, and other purposes--the expansion and balanced growth of international trade is one. From this flows the objective of promoting high levels of employment and real income and of the development of the productive resources of all members. Exchange stability is also an important objective. We know that our performance in these areas has remained well below our potential, and this has placed heavy burdens on developing countries, hindering adjustment and impeding growth. On top of existing imbalances has come this major shock to the vulnerable economies of low income oil importing countries. If at this juncture an interest subsidy scheme is not introduced, modifications to the existing Fund facilities proposed by the staff will be of little avail. Without an oil window in the CFF and an interest subsidy account, we shall not achieve a balanced package.

Mr. Thorlaksson made the following statement:

In recognition of the fact that the situation in the Middle East has exacerbated the problems of a large group of Fund members, the Nordic countries acknowledge the important role of the Fund in managing the crisis, and believe that it should be prepared to respond flexibly and be willing to extend additional financing to member countries as necessary.

At the same time, we believe that the existing facilities and policies allow for a flexibility, which, in most cases, will facilitate an appropriate response to the current difficult situation. Therefore, we see absolutely no need to create new facilities, such as an oil facility.

From these remarks, it follows that we advocate only minor adjustments to existing policies to cope with the current critical situation. Thus, changes that cannot be justified by the events in the Middle East, or which have a more permanent character, should be avoided.

In addition, the application of any modifications should, in practice, be strictly limited to cases in which the extra financing needs can be directly attributed to the Middle East situation. Needless to say, additional financing from the Fund must go hand in hand with strengthened adjustment policies, and oil price increases--as a minimum requirement--will have to be passed through to consumers in the countries concerned.

Before turning to the specific proposals, let me emphasize that, due to the high degree of uncertainty involved, developments will have to be monitored closely, particularly with respect to the Fund's liquidity position. Although at this time the Fund has sufficient resources, we note with concern the projected gradual decline in the liquidity ratio through 1991, which, combined with the present uncertainty about future Fund lending, amplifies the urgency of implementing the Ninth General Review of Quotas.

With regard to the specific proposals, I have the following remarks. First, it is difficult to understand the practicality of the proposal to temporarily suspend the lower access limits. This might, for instance, be incorrectly perceived as a signal that the Fund's conditionality is being weakened. Instead of suspending the lower access limits, we believe that the substantial margins which exist under current programs, combined with the already existing flexibility in the guidelines on access policy, are sufficient to enable the Fund to accommodate additional financing needs. This includes the possibility of going beyond the upper access limit under the exceptional circumstance clause, provided that the adjustment programs are sufficiently strong and comprehensive.

Second, and as indicated earlier, we agree that there is a need to be flexible regarding existing arrangements, and that waivers, augmentations, and extensions could be considered on a case-by-case basis when deviations from program targets or exceptional financing needs can be directly attributed to the current Middle East crisis. However, we believe that caution should be exercised with regard to rephasing of access to reduce the risk of a subsequent need for augmentation. Any rephasing will have to be followed by additional adjustment measures.

Third, the modifications to the CCFF seem appropriate at this time, as they can be justified by the need to compensate some of the countries most immediately affected. We would prefer, however, to link the changes in the CCFF directly to the events in the Middle East. Thus, the modifications should be temporary, and, in contrast to the staff's proposal to review the modifications at the time of the next review of the CCFF decision, we believe that these adjustments should lapse entirely at that time unless the Board decides otherwise.

Moreover, the Nordic countries fully support the staff's view not to extend at this stage the coverage of the CCFF to include compensation for oil imports. If, however, a specific proposal arises, we will be prepared to discuss it on its merits.

Regarding the contingency element, we support the position that efforts should be made to incorporate contingency planning into Fund-supported programs, and we favor attempts to simplify the facility, including the possibility of attaching contingency mechanisms to Fund arrangements at the time of midterm reviews. However, the experience to date with contingency mechanisms has not been particularly encouraging. Thus, we would once again urge the staff and the Board to consider a major overhaul of the facility so that it can become a principal instrument in member countries' efforts to cope with external shocks. With reference to the staff's desire to examine modifications to the symmetry clause, let me stress that the Nordic countries continue to believe that this particular clause constitutes an essential element in contingency planning, and consequently, should remain unchanged.

Fourth, we can accept the modifications to the ESAF. The possibility of a fourth-year annual arrangement, however, is only acceptable if it is applied to countries with satisfactory track records, and provided that it does not lead to a postponement of the adjustment process.

Fifth, on Board procedures, my authorities are not at all happy about the proposal to allow a temporary shortening of the circulation period for Board documents to two weeks, but are nonetheless willing to accept it in exceptional and most urgent cases.

Finally, let me conclude with a preliminary view regarding the Managing Director's proposal to establish a subsidy account. The Nordic countries continue to be reticent about it, and are particularly concerned about the implications of subsidizing the use of the Fund's ordinary resources. Despite the Managing Director's arguments to the contrary, we believe that this will lead to a weakening of the Fund's monetary character.

Mr. Posthumus made the following statement:

The Fund has been created to cope with financial and economic disturbances even if they are of systemic proportions, and to assist countries which adjust to these disturbances. We have the room for maneuver to do this. A paper which announces changes in our policies is necessarily one which promises more financing, even though, in its every line, the condition that more adjustment is required is added. Management's proposal to suspend the lower access limits is an example of that; the enlarged access policy itself already provides enlarged access.

It is unfortunate that we thus create the impression that we are not ready and able to do what we were created for. Our key instruments are our stand-by facilities. The paper rightly indicates that the fact that we have so many programs in place makes it in fact rather easy to react promptly to new adjustment and financing needs. There is sufficient flexibility in our access policies to face the new situation. But we must keep in mind that it is the Fund's primary task to work toward adjustment to new problems. Repeatedly changing our instruments and amending our rules makes us more and more liable to political pressure and ad hoc influencing. We will thus be meandering from one crisis to another, rather than following a steady course and being the central institution in the international economic system.

The proposals regarding the CCFF and oil are examples of this meandering. I recognize that we should not give the impression of sitting quietly when the world is in turmoil.

We should perhaps make clearer what our essential role is, but by reacting in an ad hoc manner we do exactly the opposite.

I have several hesitations regarding the proposed subsidy account, and I can associate myself in general with Mr. Peretz in that regard. The capacity to repay the Fund is part of our adjustment conditions; what does it mean if we say in general that countries with a low per capita income cannot pay but a rate of 0.5 percent interest to the Fund? Basically, the message is that they are not eligible for regular access. Making general resources available on special conditions also violates our equal treatment policies. Finally, the Fund's monetary character does not depend on higher or lower rates of remuneration, but rather, on the primary need of central banks for a guarantee of the liquidity of their reserves.

In the past, the U.S. chair in particular criticized the effect of front-loading compensatory drawings on the underlying program. Now, the United States proposes to accept this. I suggested a year ago that contingency planning should be included in Fund programs, and the U.S. chair was against that; now, it is supported by the United States. I continue to think that contingency elements should be built into programs, basically because they are a function of exactly the same developments which lead to a stand-by arrangement.

The Chairman said that he understood the reservations of Mr. Posthumus and Mr. Clark about the formulation of a formal Fund policy to cover the cost of oil imports under the CCFF. Nevertheless, even if such a policy were implemented on a case-by-case basis, rather than in a formal way, the member countries should be informed of what the general rule for access would be.

Mr. Goos commented that he agreed with what Mr. Posthumus had said about the subsidization of Fund drawings affecting the monetary character of the Fund. Once lending by the Fund at a subsidized rate was started, in all likelihood the Fund would be unable to contain it, and more and more Fund resources would be put into subsidized uses. There would then be a strong incentive for member countries to use the Fund's resources. A point would then be reached at which the revolving character of the Fund's resources would be impaired, and, in the end, the liquidity of the claims of central banks on the Fund. In that way, the Fund's monetary character would be affected.

Mr. Landau observed that there might be some justification to an objection to subsidizing the use of the Fund's general resources, but he had difficulty accepting the idea that the fact that members might have an incentive to use the Fund's resources in itself could be objected to.

The Fund did not operate under a market mechanism, and the relationship between the Fund and its members was not governed by the market, but rather, by conditionality. Moreover, as the Fund's experience with the ESAF had shown, the availability of very low cost resources was not always a sufficient incentive to induce countries to use Fund resources. The use of ESAF resources had been much less than had been expected when the facility was created. That being said, he wondered whether the cost of resources was a determining factor in the choice of those countries using the Fund's resources; conditionality might be a greater factor.

Mr. Goos remarked that general economic theory had it that the demand for a limited good increased with lower prices. Subsidization of a good therefore increased the demand for it. Conditionality, of course, was a stumbling block in that respect, in that through conditionality the demand for Fund resources could be limited. The question was whether conditionality could be maintained as an effective brake if vast pools of money existed in the Fund, the external environment was very difficult, the debt burdens of members high, and political pressure to ease access to the Fund's resources intensified.

Mr. Landau replied that he agreed that their was a risk of political pressure on the Fund to change the rules of access to its resources. However, the Fund's experience with the ESAF would seem to suggest that political pressure could be avoided. He would not question the conclusions of general economic theory regarding the effect of subsidization, but the fact remained that the Fund's relationship with its members was not necessarily a market relationship, in his view.

Mr. Kabbaj commented that he agreed completely with Mr. Landau. He also wished to point out that the Articles of Agreement allowed for the possibility of lowering the rate of remuneration to 80 percent of the rate of interest on the SDR--a lowering of 20 percentage points from the rate set at present. Thus, the Articles allowed for some degree of subsidization, in that a rate of remuneration of less than 100 percent of the rate of interest on the SDR was, in itself, not a market rate of interest. Consequently, creating a subsidy account along the lines of what the Managing Director had suggested would not be the first instance of subsidization in the Fund's history.

Since the Managing Director's proposal did not contemplate direct subsidization, the Fund's monetary character and its financial integrity would not be jeopardized, Mr. Kabbaj observed. Indeed, subsidies would only be available if the necessary resources were provided by donors. The Fund would therefore receive in charges exactly the same amount it would have received in charges from resources made available in the usual way.

Mr. Kafka recalled that until 1968, the use of Fund resources was heavily subsidized, in comparison with market rates of interest, for about the first year. At that time, he could not recall that anyone had been concerned that such a subsidy would interfere with the monetary character of the Fund.

Mr. Goos remarked that at that time, countries had relatively easy access to other financial resources. The situation had changed somewhat since then.

The Executive Directors agreed to continue their discussion in the afternoon.

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/90/154 (10/26/90) and EBM/90/155 (11/2/90).

4. THE GAMBIA - REPRESENTATIVE RATE FOR GAMBIAN DALASI

The Fund finds, after consultation with the authorities of The Gambia, that the representative exchange rate for the Gambian dalasi under Rule O-2, paragraph (b)(i), against the U.S. dollar, is the midpoint of the buying and selling rates for the U.S. dollar as determined by the Central Bank of The Gambia. (EBD/90/360, 10/26/90)

Decision No. 9576-(90/155) G/S, adopted
November 1, 1990

5. EXECUTIVE DIRECTORS' OFFICES - TEMPORARY STAFFING

The Executive Board approves the recommendation of the Committee on Executive Board Administrative Matters regarding the request for an extension of the temporary additional positions in Executive Directors' offices as set forth in EBAP/90/276 (10/26/90).

Adopted October 30, 1990

6. INDIVIDUAL STUDY PROGRAM - DEVELOPMENTAL LEARNING

The "Individual Study Program III" policy is expanded to include support for developmental learning through courses or programs at the graduate level in the main areas of work in the Fund. The Fund will reimburse 75 percent of the tuition and laboratory fees for the approved courses that are successfully completed and that have been approved by the Fund in advance. (EBAP/90/274, 10/24/90)

Adopted October 29, 1990

7. STAFF MEMBER - LEAVE WITHOUT PAY

The Executive Board approves the proposal set forth in EBAP/90/275 (10/25/90) concerning an extension of leave without pay for a staff member.

Adopted October 31, 1990

8. APPROVAL OF MINUTES

The minutes of Executive Board Meetings 90/15 and 90/16 are approved.

9. EXECUTIVE BOARD TRAVEL

Travel by Executive Directors as set forth in EBAP/90/279 (10/30/90) and EBAP/90/280 (10/31/90) and by Assistants to Executive Directors as set forth in EBAP/90/272 (10/24/90) and EBAP/90/273 (10/24/90) is approved.

APPROVED: September 4, 1991

LEO VAN HOUTVEN
Secretary