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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 88/94

10:00 a.m., June 17, 1988

M. Camdessus, Chairman

Executive Directors	Alternate Executive Directors
A. Abdallah	E. T. El Kogali
F. Cassell	
Dai Q.	
C. H. Dallara	
J. de Groote	
A. Donoso	E. V. Feldman
M. Finaish	
	B. Goos
	J. Reddy
A. Kafka	
	W. N. Engert, Temporary
	N. Toé, Temporary
Y. A. Nimatallah	I. A. Al-Assaf
G. Ortiz	L. Filardo
J. Ovi	M. Fogelholm
H. Ploix	D. Marcel
G. A. Posthumus	G. P. J. Hogeweg
C. R. Rye	
	S. Rouai, Temporary
A. K. Sengupta	
K. Yamazaki	
S. Zecchini	N. Kyriazidis

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

Also Present

African Department: A. D. Ouattara, Counsellor and Director; G. E. Gondwe, Deputy Director; A. B. Taylor. Asian Department: R. J. Hides. European Department: M. Guitián, Deputy Director. Exchange and Trade Relations Department: L. A. Whittome, Counsellor and Director; J. T. Boorman, Deputy Director; H. B. Junz, Deputy Director; M. Allen, D. Burton, S. Kanesa-Thasan, G. Oliveros, J. P. Pujol, M. H. Rodlauer, B. C. Stuart. External Relations Department: R. J. Bhatia, Director, Fund Office of the United Nations and Special Representative to the United Nations; D. M. Cheney. Fiscal Affairs Department: K.-Y. Chu, K. Nashashibi. Legal Department: T. M. C. Asser, A. O. Liuksila. Research Department: J. A. Frenkel, Economic Counsellor and Director; A. D. Crockett, Deputy Director; M. Goldstein, Deputy Director; R. G. Alter, D. A. DeRosa, D. Folkerts-Landau, E. Hernández-Catá, N. M. Kaibni, M. S. Khan, P. R. Menon, R. Pownall, B. E. Rourke. Secretary's Department: C. Brachet, Deputy Secretary. Treasurer's Department: D. Williams, Deputy Treasurer; D. Gupta, Y. Ozeki. Western Hemisphere Department: J. Ferrán, Deputy Director; C. M. Loser, L. L. Pérez. Personal Assistant to the Managing Director: H. G. O. Simpson. Advisors to Executive Directors: A. A. Agah, M. B. Chatah, A. G. A. Faria, H. S. Hassan, A. R. Ismael, Khong K. N., K.-H. Kleine, P. Péterfalvy, D. C. Templeman, A. Vasudevan, Yang W., J. E. Zeas. Assistants to Executive Directors: N. Adachi, J. R. N. Almeida, S. Appetiti, D. Barr, H. S. Binay, R. Comotto, E. C. Demaestri, V. J. Fernández, B. Fuleihan, S. Guribye, C. L. Haynes, A. Iljas, J. M. Jones, C. Y. Legg, V. K. Malhotra, L. M. Piantini, D. Saha, C. C. A. van den Berg, E. L. Walker.

1. COMPENSATORY AND CONTINGENCY FINANCING FACILITY - MODALITIES

The Executive Directors considered a staff paper on modalities for the compensatory and contingency financing facility (EBS/88/100, 5/24/88; and Cor. 1, 5/25/88). They also had before them a staff paper updating the Fund's liquidity position (EBS/88/115, 6/10/88).

The Staff Representative from the Research Department made the following statement on transitional provisions for use of the compensatory financing facility:

> The Managing Director has expressed the hope that sufficient progress will be made at this discussion of the modalities for the compensatory and contingency financing facility to enable a decision establishing the new facility to be approved by the middle of July. Until the new decision is in place, however, there is the important question of how to approach requests for purchases under the compensatory financing facility. It would seem reasonable that members currently in active discussion with the Fund staff for compensatory financing should continue to be governed by the existing decision, even though their requests may not reach the Board until after the new decision has been approved. Equally, it is important that a date is established beyond which discussions that begin on drawings under the compensatory financing facility would be guided by the provisions for compensatory financing under the new decision. This would remove any uncertainty for the membership concerning the specific compensatory financing decision under which a request will be processed. For discussions initiated beyond an established date, the agreed provisions that would govern access under the compensatory financing element of the new facility as contained in the Managing Director's informal remarks of April 7 (see IS/88/5, 4/7/88) would guide the staff in their discussions with the authorities.
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> In view of these considerations, the staff would propose the following transitional procedures. Any discussions on use of the compensatory financing facility commencing after the present Board meeting (EBM/88/94) would be governed by the provisions of the new decision. For discussions that have begun prior to that date, the provisions of the existing decision would continue to apply, even though formal requests in these cases might not be brought before the Board until after the new decision is in place. Here, however, it would not seem appropriate that the period for presenting these cases to the Board be open ended. A period of three months would seem sufficient to allow for conclusion of negotiations already under way and for their consideration by the Executive Board.

Executive Directors may wish to give their views as to whether the approach outlined above would be acceptable. If so, the proposed transitional arrangements could be accommodated by a suitable provision in the new decision.

The staff representative from the Exchange and Trade Relations Department made the following statement on the design of contingency mechanisms:

The staff paper on the modalities for the compensatory and contingency financing facility (EBS/88/100) suggested general principles that could govern the operation of external contingency mechanisms. To provide additional insight into how these principles might be applied in individual cases, the staff of area departments has considered the design of possible contingency mechanisms for a sample of 19 actual or potential arrangements. The sample included low-income primary-commodity exporters and middle-income countries with a more diversified export base; it also included official as well as market borrowers. The arrangements underlying the exercise included 14 stand-by arrangements, three arrangements under the enhanced structural adjustment facility and two extended arrangements.

The features of external contingency mechanisms considered were: the exogenous factors to be covered; access under the contingency mechanism; the size of the threshold; and the proportion of a contingent deviation above the threshold to be covered by Fund financing. This statement reports the results of that exercise. It should be emphasized that because of the hypothetical nature of the experiment and the limited time that was available, the results should be interpreted with considerable caution, and should be taken as providing only a broad indication of the main features and possible ranges for key parameters of external contingency mechanisms.

This exercise has helped confirm that the general guidelines set out in the staff paper were useful in developing the operational aspects of external contingency mechanisms. At the same time, the exercise demonstrated that the setting of key external contingency mechanism parameters and the calculation of contingent deviations may in some cases be complicated and involve difficult judgments. The Executive Board's discussion on the operational modalities of the external contingency mechanism and Board consideration of early cases under the proposed new facility would be expected to provide additional guidance for determining the specific features of external contingency mechanisms in individual cases.

The variables most frequently chosen for coverage in external contingency mechanisms in the experimental exercises included export prices for a limited number of key commodities, the price of imported oil, and international interest rates. The exercise suggested that it would not be appropriate to adopt specific values for the basic operational parameters in external contingency mechanisms to be applied in all cases. At the same time, however, most parameter values clustered within a range that was sufficiently narrow to give staff and country authorities more specific guidance than that provided in the staff paper on the way in which external contingency mechanisms may tend to operate in early cases. For example, in 15 of the 19 cases, the value of the threshold fell between 0.2 percent and 0.6 percent of GDP and the proportion of the deviation that it appeared appropriate to finance through the Fund was between 33 percent and 60 percent. As regards access, in 13 cases access was constrained either by the general limit of 70 percent of the underlying arrangement or by the maximum access available under the proposed facility; in the other cases, lower access was considered appropriate in part to allow for adequate contingency financing in possible subsequent arrangements.

The main factors taken into consideration in suggesting these parameters included the scope for further policy action, the country's reserve position, the possible availability of parallel contingent financing, the maximum access available under the external contingency mechanism, and the need to reserve adequate contingency access for future arrangements.

In general terms, as set out in EBS/88/100, external contingency mechanisms would cover unanticipated changes in the exogenous components of export earnings, import prices, and interest rates, with other exogenous current account items being covered when they are of particular importance. In the exercise, commodity export prices were included in the list of contingent variables for 16 out of the 19 countries, with the number of commodities included for any given country generally ranging from one to four. Coverage of the impact of unforeseen changes in external demand on manufacturing exports was included in four cases. The effect on export volumes of changes in commodity prices was considered in three cases; for some countries that were dominant producers of a commodity, a judgment had to be made as to whether a deviation in export volume was beyond the member's control. The price of imported oil was included for 12 countries, and international interest rates for 11 countries. In five cases, coverage of tourist receipts was judged to be important; three included workers' remittances. Import prices other than oil were considered in three cases.

In selecting the subset of variables to covered under the external contingency mechanism, emphasis was placed on the need to include a substantial proportion of the exogenous components the number of contingent variables and avoiding complications that might delay agreement on programs or the activation of the mechanism. In some cases, it was felt that available data were not sufficiently reliable to warrant inclusion of certain items (notably for import prices and workers' remittances), even though they accounted for a sizable proportion of the country's external transactions.

With regard to export and import prices, in several cases specific reference was made to the impracticality of using national data on unit values for the purpose of estimating contingent deviations, because of the lengthy publication lags involved. This finding was confirmed by a more broadly based staff survey of publication lags for trade data in developing countries. It is suggested that in such cases, data on the relevant international prices be used instead of unit values. This may involve in some instances difficult judgments about the impact of contractual and timing differences on the cash value of transactions, judgments that also are necessary in formulating the balance of payments projections underlying the basic arrangement.

As noted above, in 13 cases in the sample, access up to either the general limit of 70 percent of the underlying arrangement or the maximum access available under the proposed facility was viewed as appropriate. In seven cases, the amount of contingent financing potentially available was set at 70 percent of the amount of the associated arrangement; in all instances this could allow for some contingency access, if required, under subsequent arrangements. In one case it was suggested that the amount of financing should be 65 percent of quota, which was less than 70 percent of the associated arrangement, and for five countries, contingent financing was constrained to be less than either 65 percent of quota or 70 percent of the underlying arrangement because compensatory financing facility purchases outstanding exceeded 40 percent of quota. Access for six countries would have been limited to less than 70 percent of the associated arrangement or the maximum available under the facility, in part to allow for adequate contingency financing in possible subsequent arrangements. As regards the distribution of contingency financing within multiyear arrangements, in some cases the carry-over of unutilized access to later years in the program was suggested, and it was considered appropriate to front-load access in one multiyear arrangement as a precautionary measure.

The suggested threshold size ranged from 0.1 percent to 0.9 percent of GDP; in 15 cases, the threshold fell within the band of 0.2 percent to 0.6 percent of GDP. Expressed in terms of quota, the threshold ranged from 5 percent to 36 percent of quota.

The scope for using reserves to absorb shocks was an important determinant of threshold size in many instances. In several cases, the suggested threshold was also set to avoid the triggering of the mechanism for deviations that were in the range of typical forecast errors; it was felt that smaller shocks should be absorbed by margins in the basic arrangement. The scope of further policy action, given the adjustment that had already been undertaken, was a factor limiting the size of the threshold in some instances.

In all cases in the sample, application of the external contingency mechanism involved a mix of adjustment and financing. for the sample countries, the proportion of the deviation to be financed by the Fund in the year in which the deviation occurred varied from 33 percent to 75 percent; in 15 of the 19 cases the proportion of deviation to be financed fell within the range of 33-60 percent, and in 12 cases within the range of 40-60 percent. The amount of contingent financing that was likely to be forthcoming from other sources, especially commercial banks in cases where interest rates were covered, was an important factor accounting for differences in the proportion across countries. 1/ Other factors that influenced the selection of the proportion were the maximum size of external shock to be covered by the contingency mechanism, and the scope for further quick policy action.

The Chairman suggested that Executive Directors, after making brief general comments, focus their remarks on the five main questions at hand: the external contingency element, the compensatory element, the cereal decision, the optional tranche, and the transitional period. Given the Board's work program, it would be desirable to conclude discussion of the

1/ More uniform results would have been obtained if the availability of parallel financing for interest rate contingencies had been taken into account by adjusting the proportion of the country's external debt that is eligible for contingent Fund financing rather than by altering the proportion of the net deviation to be covered. Adjusting the proportion of the country's external debt that is eligible for contingent Fund financing would be symmetrical with the proposed treatment of other forms of insurance against unforeseen changes in international interest rates, such as interest rate futures and swaps, which aim at avoiding the provision of Fund financing where unforeseen events have no cash effect on the balance of payments. With such an approach, the proportion of the net deviation to be financed by the Fund in cases where parallel financing was to be made available would have been higher, and the range for the proportion of deviation to be financed by the Fund would have been substantially reduced.

compensatory and contingency financing facility by July 14, so that the entire package could be presented to the Interim Committee at its September meeting.

Mr. Rouai, speaking on behalf of Mr. Salehkhou, made the following statement:

> At the outset, I must recall that, prior to the meeting of the Interim Committee, I did not join in the compromise to combine the compensatory financing facility and the external contingency mechanism into a single facility. In addition to the various reasons elaborated upon in our frequent discussions, I was mainly apprehensive of losing the many beneficial and highly desirable essential features characterizing the compensatory financing facility and those which were proposed by the Group of Twenty-Four to make external contingency mechanisms potentially just as desirable as a Fund facility. Now that the combination of the two facilities has been decided upon, I strongly feel that today's discussions should pay particular attention to the preservation of the compensatory financing facility's essential features, a principle which the Board had repeatedly emphasized and which has also been confirmed by the member for my constituency at the Interim Committee as a condition for his joining the compromise.
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> Given the variety of the remaining issues relating to the combination of the two facilities, I propose to organize my intervention basically in the same order that the staff has introduced the issues in the paper. For the sake of brevity, I will simply enumerate, for every set of issues, those on which my position concurs with the staff proposal before addressing the remaining issues.
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> On the operational modalities for external contingency mechanisms, I can support the exclusion of external contingency mechanism purchases from the limits specified under the policy under enlarged access as well as for the purpose of determining member's reserve tranche position. Accordingly, I can also support use of ordinary resources to finance external contingency mechanism purchases on the same basis as the compensatory financing facility, with a repurchase period of three to five years. Such a principle results from the combination of the two facilities, and cannot be disputed if the optional tranche is to be administered smoothly.
>
> However, the remaining staff proposals regarding the amount of contingent Fund financing are rather restrictive. To confirm my understanding of the proposals, first, there is the access limit of 40-65 percent of quota. Second, the amount of contingent financing in an individual arrangement would not generally exceed 70 percent of the access under the associated arrangement. Third, such financing

Third, such financing would be available for disturbances above a minimum threshold level. Fourth, only a proportion of the contingent deviation beyond this threshold would be financed by the Fund. Fifth, the amount of contingent financing available for the entire period of the arrangement would be divided into annual portions. Sixth and finally, the annual portion will be phased with the purchases under the associated arrangement and will be subject to observance of performance criteria.

I will now briefly elaborate on these procedures. First, I have nothing to add regarding the limits of 40-65 percent of quota, since there already exists a consensus on that point.

Second, as for the limit of 70 percent of the access under the associated arrangement, a simple calculation shows that if such limit is to be superimposed on the first limit of 40-65 percent of quota, the associated arrangement cannot exceed 57-93 percent of quota. Beyond these amounts, the limit of 70 percent will, in effect, be inoperative. Therefore, the external contingency mechanisms would adequately cover only a small proportion of the Fund's arrangements, particularly in the case of stand-by arrangements or arrangements under the structural adjustment facility. Arrangements under the extended Fund facility or the enhanced structural adjustment facility exceeding 93 percent of quota will not be adequately covered by the external contingency mechanisms because contingent financing will be limited, in all cases, to a maximum of 40 percent of quota or, at best, 65 percent of quota.

Third, if the other limits are to be applied, particularly those covering extended arrangements, contingent financing will be rather small. Such conclusion is reinforced by the staff, which indicates that "in some cases the contingent financing available during an annual program of a multiyear arrangement would be less than that available under a one-year stand-by arrangement."

In short, and taking into account these limitations, I propose: to exclude the limit of 70 percent; to retain the principle of fixing a threshold on a case-by-case basis; to exclude the principle of fixing a proportion of contingency financing to be financed by the Fund beyond the threshold since external contingency mechanisms are already limited by the access limit and by the threshold level; and to front-load contingency financing so as to facilitate rapid alleviation of the impact of the contingency on borrowing members.

As for the remaining issues relating to the operational modalities for external contingency mechanisms--namely, calculation of contingent financing, activation, and symmetry--I can go along with the staff proposals. On coverage, however, and as I indicated in previous occasions, I can support coverage of export earnings, import prices, tourism receipts and migrant workers' remittances. I also continue to endorse the G-24 proposal regarding the development of a growth contingency mechanism and would call for the extension of coverage to exchange risks in view of the uncertain exchange markets. In this respect, this chair was one of those which not only expressed reservations, but also argued against the coverage of interest rates in external contingency mechanisms on the ground that such coverage encourages manipulation and maintenance of those rates at artificially high levels. Now that the staff is proposing the coverage of interest rates, I feel strongly that the coverage should also be extended to exchange rate fluctuations. This would encourage stability in the market somewhat, given the established link between the two rates. Specifically, the "interest parity theory" on which analysis of exchange markets frequently relies relates exchange rate to interest rate differentials. It maintains that, in equilibrium, exchange rates are directly related to interest rate differentials. My proposal would also be in line with the purposes of the Fund, which according to the Articles include promoting exchange stability, maintaining orderly exchange arrangements among members, and avoiding competitive exchange depreciation.

Regarding the compensatory financing facility, let me state at the outset that I regret that the staff has failed to identify the essential features of compensatory financing facility and to explain how those features are to be preserved under the new combined facility, despite the request made by this chair. This, as already mentioned, was clearly a commitment that both the Board and the Interim Committee undertook as a condition for agreement to the combined facility. If we consider low conditionality, quick and automatic disbursement, and a relatively high access as some of those essential features, I wonder whether the staff can convincingly argue that such features have indeed survived under the new combined compensatory and contingency financing facility. It has been agreed that in extreme cases when a member has a satisfactory balance of payments position except for the effect of the export shortfall, the member would still be entitled to purchase up to 83 percent of quota under the compensatory and contingency financing facility. Even so, I maintain that compensatory access for most developing countries will be reduced and made subject to higher conditionality. The staff has already drawn this conclusion by stating, in EBS/88/115, that "the projection for use under the compensatory financing facility for 1989 has been reduced by SDR 0.5 billion to SDR 1 billion, mainly reflecting lower access under the compensatory financing facility partly because some members are not expected to qualify for access at 83 percent of quota under new guidelines...." This clearly summarizes the outcome of the compensatory financing facility review.

I can endorse the tranching of the compensatory element into two tranches of 20 percent each. I also agree that an arrangement in principle would meet the test of cooperation for a compensatory financing purchase. I can go along with the principle of adjustment for overcompensation, which should also symmetrically apply in cases of undercompensation. However, I cannot support a projection limit of 20 percent on export growth in the shortfall year.

As for the cereal decision, I can support Alternative A or Alternative B proposed by the staff in Annex I, namely, to preserve the external contingency mechanism element at 40 percent and raise the joint limit for export shortfalls and cereal excesses beyond 65 percent.

I strongly believe that complete flexibility should be provided to member countries to allocate the optional tranche to compensatory financing facility or to external contingency purchases without any constraints on the duration for this choice.

I can go along with the staff proposals regarding the transitional provisions for use of the compensatory financing facility.

I must indicate that it is not clear to me under what circumstances a country with a Fund arrangement could use the compensatory element. I understand that external contingency mechanisms are an advance financial commitment made at the outset of Fund arrangements to cover contingency deviations in exports and other eligible current account components. Therefore, as long as a country is under a Fund arrangement, export shortfalls would be treated as a deviation from the program scenario and consequently could be eligible for the contingent financing specified by the program. By the same token, I conclude that as long as a country is under a stand-by or extended arrangement, or an arrangement under the structural or enhanced structural facilities, it could not benefit from the compensatory financing facility. If this is not the case, one must necessarily conclude that the same export shortfall, currently financed through a unique facility--the compensatory financing facility--will now have to be financed through two different facilities with essentially different conditionalities, not to mention the issue of double compensation. Staff clarification on this point would be helpful.

To conclude, I concur with the staff that, given the lack of experience with several features of external contingency mechanisms as well as the changes introduced in the compensatory financing facility, the Board should proceed cautiously in the implementation of the new combined facility. I hope that individual requests made under this facility will be considered by the Board in a cooperative spirit.

Mr. Ortiz made the following statement:

We now face the challenging task of establishing the operational modalities of the compensatory and contingency financing facility, as it appears to have finally been named. It would be unrealistic to expect to define in detail all the operational aspects in this discussion, or in subsequent sessions that may be needed. Clearly, we will need some experience with the implementation of this facility to obtain a better feeling for the issues involved. Nevertheless, we should aim to establish as precise operational guidelines as could be reasonably expected at this stage, with a view to assuring uniformity of treatment. I turn now to comment on the specific issues, without attempting to modify or raise questions on those areas in which it is our understanding that we have reached a previous agreement.

On overall access, since we had previously agreed on access limits, I will only say that we support access limits for the new facility that are outside the limits specified on enlarged access, as is now the case for the compensatory financing facility. We also agree with the proposed annual distribution of contingent financing in multiyear arrangements, although attention should be given to front-loading access to this facility in circumstances when it is particularly desirable to clear the financial horizon at the beginning of the program.

We had previously expressed our agreement with the notion of a minimum threshold. Furthermore, we understand that, given the particular circumstances of each member, it would not be practical to attempt to set a globally applicable threshold. Nonetheless, we feel that, at this stage, it should be possible to establish some guidelines to define which criteria should be used in the determination of minimum thresholds. We would need some more discussion on this point, and the staff--on the basis of the survey results noted in footnote 2 on page 5 and other information--should be able to provide some proposals for Board consideration. I am made somewhat uneasy by the staff's implication that the existence of contingent financing may--paradoxically--given rise to the buildup of more extensive "margins" in Fund-supported programs.

In previous discussions, we have strongly underlined the importance of providing the member, at the outset of a program, with a clear view of the type and amount of contingent financing, as well as on the mix of adjustment and finance in the event of an activation of the new facility. We thus welcome the staff's indication that it has gone further in this direction.

As regards coverage, I have two basic comments. First, in situations where the flow of foreign finance specified in the program fails to materialize, I basically agree that the Fund should not systematically substitute for shortfalls in lending by other creditors. However, this chair is of the view that we should not preclude the possibility of activating contingent financing on the part of the Fund in some exceptional cases in which it appears to be warranted. There are some instances in which it may be considered appropriate for the Fund to extend additional finance if there are delays in credit disbursement from other sources that could threaten the achievement of the program's objectives. In these cases, it may be specified in advance that early repurchases of contingent financing would take place once the financing from other sources materializes.

Second, in relation to coverage of interest rates, we agree that external contingency mechanisms should cover nominal changes. Despite the theoretical advantages that may be found in focusing on real rates, it seems clear that there are a number of practical difficulties. However, we oppose placing limitations on coverage of interest costs. We see no reason why interest rates should be singled out, inasmuch as interest variations constitute external shocks of a similar nature to that of others covered by this facility. The available hedging mechanisms are both limited and costly, and it is doubtful that they could be effectively utilized in the context of concerted lending packages.

On the calculation of contingent deviations, the aggregate size of these deviations should be calculated as the net sum of deviations from baseline values, as suggested by the staff. Regular updating of key world economic outlook projections would be required for the purpose of establishing baseline projections.

On the question of activation, phasing, and monitoring, I would note that a careful compromise was reached during our previous round of discussion between those Directors who favored more automaticity and those who did not. The second paragraph of page 11 reproduces the wording of the Managing Director's statement (buff document 88/68), which contemplates the possibility--in some exceptional cases--of activating contingent financing without a formal Board decision (although, in all cases, the Board would be informed). The subsequent paragraph, however, implies that reviews would be required in all cases, but that in some instances "involving clear advance contingent policy understandings," the review and associated external contingency mechanism purchase might be approved on a lapse of time basis. We should keep in mind the difficult balance achieved in previous discussions, and would appreciate a final clarification of this issue.

We endorse the principle of symmetry with respect to contingent financing. In general, favorable developments should be reflected in a strengthening of the reserve position. Symmetry of Fund financing, however, should apply only to purchases under the contingent portion of the compensatory and contingent financing facility. If the strengthening of the external position is sustainable, the Fund could express the expectation that a member should voluntarily limit further purchases. However, we oppose the mandatory reduction of the utilization of Fund resources under the basic agreement.

Regarding the type of Fund arrangements eligible for external contingency mechanisms, we propose that consideration be given to the utilization of the contingent portion of the compensatory and contingency financing facility for countries under enhanced surveillance arrangements with the Fund. Since these arrangements involve the evaluation and monitoring of a quantified economic program, it could be possible to incorporate external contingency mechanisms in much the same way as is done with other types of Fund arrangements. In these cases, access limits--under the 70 percent rule--would be calculated with reference to an average access under previous arrangements.

We agree that the new compensatory and contingency financing facility should be financed on the same basis as the contingency financing facility, with ordinary resources.

Regarding the search for contingent support from other sources, we agree that the Fund should attempt to strengthen its catalytic role by seeking the support of other creditors in the provision of contingent financing at an early stage of program negotiations. This consideration, however, ought to be balanced with the more practical need to avoid undue delays in the setting up of financial arrangements.

The staff's proposal to limit the external contingency mechanism coverage of interest rate deviations to cases where bank creditors were also willing to provide parallel contingent financing is unacceptable. This is tantamount to eliminating interest coverage since, as the staff knows, it is even more difficult for banks to engage in contingent financing than it is to participate in concerted lending packages. And in the prevailing circumstances, it is well known that banks are not precisely eager to participate in concerted lending.

Regarding the guidelines for cooperation, I generally agree with the staff's discussion in pages 17-19, which clarifies some of the earlier understandings. For members with a less satisfactory record of cooperation, we agree with the symmetric division of the compensatory element, namely, 20/20. Arrangements under the structural and enhanced structural adjustment facilities should, of course, be included in the interpretation of "arrangements with the Fund" in the 1983 guidelines for cooperation.

With respect to the use of the optional tranche for those countries with an unsatisfactory record of cooperation, it may be recalled that a compromise was reached during our previous discussion--as reflected in the wording in the Managing Director's statement (buff document 88/68, Final Version)--in the sense that this tranche would "generally be expected to become available upon program review." But this does not preclude the possibility of countries having access to this optional tranche in some exceptional cases--where prior actions are sufficiently strong--upon program approval. Again, the staff's discussion is not clear on this point.

In relation to approving compensatory financing purchases in principle, I would only reaffirm the position of this chair in the sense that arrangements approved in principle clearly meet the test of cooperation for a compensatory financing purchase on the upper tranche. Consequently, compensatory financing disbursements should proceed immediately after approval in principle.

With respect to the cereal decision, we agree that symmetry considerations suggest an entitlement of 83 percent of quota in cases of a cereal excess, for members having a satisfactory balance of payments position. Where an export shortfall and cereal excess occur simultaneously, we would favor the preservation of existing entitlements.

On the calculation of compensable shortfalls, we endorse both the staff's suggestion on projection limits and the mechanisms for adjustment in cases where overcompensation had occurred.

As regards the operational tranche, we--as in the past--support total divisibility between the compensatory and contingency components. Consistent with this view, we also favor total freedom in the allocation of the optional tranche. The staff mentions that if members had complete flexibility as to the use of the optional tranche, there would be some uncertainty as to the total amount of contingent financing available, thereby posing potential problems for other creditors on the provision of parallel contingent financing. This, however, does not appear to be an excessively difficult problem, since limits on parallel contingent financing would be specified up to the total optional tranche, but subject to reduction on account of drawings under the compensatory element. Thus we see no compelling reason for not providing total flexibility on the operation of the optional tranche.

Regarding transitional arrangements for members with outstanding compensatory financing purchases, we agree with the staff's suggestions.

In relation to the treatment of double compensation for an export shortfall under the compensatory and contingency elements portions, we also agree with the methods proposed by the staff in pages 25 and 26.

Extending his remarks, Mr. Ortiz said that while it would be unrealistic to try to define all operational aspects of the new facility before gaining operational experience with it, the Board should aim at establishing as precise guidelines as could be expected. For example, on the minimum threshold, Mr. Dallara and Mrs. Ploix had both proposed guidelines that had the virtue of simplicity and should be considered further.

On his suggestion that countries under an enhanced surveillance arrangement with the Fund be allowed access to contingency financing, he realized that some Directors had problems with the concept of enhanced surveillance and regarded the Fund's previous experience with that type of arrangement as less than satisfactory, Mr. Ortiz said. However, if the Fund was to be consistent with the debt strategy it had followed so far, it should aim at strengthening programs under enhanced surveillance, which could be done by providing contingency financing.

His authorities could not go along with the staff proposal to limit contingency coverage of interest rate deviations to cover cases in which bank creditors were willing to provide parallel contingency financing, Mr. Ortiz remarked. That would be tantamount to having no interest rate coverage at all.

Mr. Kafka made the following statement:

We do not agree with the staff's proposals regarding transitional provisions. The staff has had ample time to propose transitional provisions since the end of the meetings of the Interim Committee, and there is no justification for springing on the Board on June 14, 1988, a proposal that is to go into effect on June 17, 1988. Moreover, the proposal is impossibly vague. The clause in the third paragraph of the staff statement on transitional provisions: "For discussions that have begun..." leaves it entirely to the discretion of the Fund to define what a discussion is. We, therefore, propose that a list should be circulated by the staff to each Executive Director naming the countries that in his or her constituency the staff considers to have "begun discussions on a compensatory financing facility drawing." The Director could add other countries to this list, which, in his opinion, "have begun discussions." All these countries would be subject to the present contingency financing facility regulations if the discussions resulted in an agreement on a compensatory financing facility drawing within a reasonable period. We would, furthermore, wish to make clear that we have not had a chance to study carefully the implications of the staff statement on the design of contingency mechanisms and, therefore, will not feel bound by any implications that could be drawn from that statement in our eventual decision on the combined external contingency mechanism and compensatory financing facility.

In formulating our comments, we must also take into account that what we face is essentially a certain reduction in compensatory access, possibly offset by contingent access. Since contingent access is heavily qualified and circumscribed by conditions which must, at the very least, mean major delays in using the new contingency mechanism, the introduction of any Byzantine complications additional to those included in the Managing Director's informal remarks of April 7, 1988 (IS/88/5), must be avoided.

We disagree with the suggestion on page 4 of the staff paper establishing any rule about the relationship between annual access in multiyear arrangements under external contingency mechanisms and under the underlying arrangements. External contingency mechanisms are designed to deal with deviations from expectations, and there should be no constraint, even in principle, in allowing access under them to vary as may be required by the nature of the contingency. There should, therefore, be no fear of front-loading if the contingency appears to justify it. In all cases, the carry-over of contingent access unused from an earlier period should be permitted.

The recommendations contained in Section 2.b of the staff paper threshold seem very much like an exercise in Byzantinism--in particular, those in the second paragraph beginning on page 6. We would prefer, initially at least, very simple and general rules over country-specific rules. The latter leave too much discretion to the Fund.

The staff proposals on the nature of the Fund's commitment require particularly careful examination to avoid unnecessary complications. To give a country the benefit of the doubt, though not an overwhelming benefit of the doubt, when it requests activation of an external contingency mechanism, would be helpful in making the proposed external contingency mechanism credible as a useful innovation rather than as a mere disguise for reducing access under the compensatory financing facility.

We have no objection to the substantive proposals contained under the heading of coverage. However, we would like to draw the Board's attention to the rather significant first sentence of the last paragraph beginning on page 7: "Coverage...would be determined...in discussion with the authorities." How else can it be determined, since it is obvious that no mechanical rules for coverage can be written? Obviously, the authors of the paper find it unusual and requiring special mention that one should take the views of the authorities of the interested country into consideration. Some limits must be set--here and elsewhere--to the Fund's discretion.

We reject any restrictions other than those contained in the Managing Director's informal remarks regarding financing of interest rate contingencies. The substantive arguments proposed in the first paragraph of page 9 of the staff paper are convincing on this point. Moreover, the Managing Director's informal remarks constitute a delicate compromise; if one part of his statement is changed, the whole compromise is invalidated. For the same reason, we reject any requirement that the Fund's interest contingency mechanism should be activated only if financing for interest contingency is also made available from other sources.

As we already mentioned at an earlier stage of the discussion--before the spring meeting of the Interim Committee--we welcome reliance on world economic outlook projections of key variables to help determine the size of deviations from original assumptions. Once the monetary interest of the Fund is involved, one could, perhaps, hope that the excessive optimism of these projections will be corrected. In this connection, we are very concerned about the manner of dealing with countries with diversified exports.

Subjecting activation of external contingency mechanisms to review largely destroys their value from the point of view both of the country concerned and of its creditors. However, for the time being at least, we have to adhere to the recommendation of the Interim Committee. However, we hope that, in practice, the Fund would avoid lengthy delays that could well destroy the value of the external contingency mechanism. We are, therefore, greatly concerned with the second paragraph at the bottom of page 12, which suggests that the authors of the paper do expect reviews for the purpose of activating external contingency mechanisms to be long drawn out. Regarding symmetry, our preference in all cases would be for increasing the reserve target rather than for early repurchases.

We disagree with the proposal not to incorporate external contingency mechanisms into existing arrangements under the structural adjustment facility. It is not necessary to go by the formal characteristic that such arrangements have only annual benchmarks and no performance criteria. This characteristic should not be made into an obstacle to the use of external contingency mechanisms in connection with arrangements under the structural adjustment facility, nor a vehicle for pressuring countries with such arrangements to replace them by arrangements under the enhanced structural adjustment facility. One suggestion for overcoming the absence of performance criteria would be to be satisfied with an ad hoc review when a contingency was claimed to occur.

We strongly support the position that approval, in principle, of an arrangement--whether a stand-by or extended arrangement or an arrangement under the structural or enhanced structural adjustment facilities--should be deemed to meet the test of cooperation without qualification.

Regarding the cereal facility, we note that the only logical suggestion is adumbrated, but not spelled out, in the staff paper. If 105 percent is the combined ceiling for the cereal and compensatory facilities, and also for the compensatory and contingency facilities, it would be absurd for the combined ceiling for these three facilities also to be 105 percent. Rather, it should exceed the 105 percent ceiling for the compensatory financing facility at least by the same percentage of quota by which the compensatory and cereal facilities ceiling exceeds that of either facility, namely, 22 percent of quota.

Regarding calculations of compensable shortfalls, we agree with the institution of a limit of 20 percent for the time being. This limit should be reviewed as soon as the annual inflation rate (for example, among the Group of Seven) over a three-month period has exceeded the inflation rate which underlay the 20 percent limit. We also agree to the proposals regarding overcompensation, provided that any undercompensation would also be compensated.

We agree that the use of the optional tranche should be completely divisible, but do not consider that any particular choice should have to be made at any particular time. Any part of the optional tranche should be available at any time for compensatory financing facility or external contingency mechanism use as the country desires. Forcing a country to make a choice for a certain period of time would greatly reduce the value of the facility to member countries. It is one of the many examples we find in this institution of a pervasive distrust of member countries, who do not wish to be governed from Washington, not even by the Fund.

Regarding the transitional arrangements, our suggestion would be to take up the proposal made by the United States at one point to allow total access to rise beyond 105 percent to a limited extent where a country has used more than 65 percent of its total access for compensatory financing access.

Regarding double compensation, our feeling is that it is of particular importance not to seek too much precision in disaggregating a shortfall calculation so as to exclude that part of a shortfall that triggered a contingency. In other words, we do not object to the principle proposed by the staff, but we would object very strongly to any delays that resulted from excessive precision in eliminating double compensation.

Regarding the liquidity of the Fund, we consider that there is no particular danger to be feared.

Mr. Dallara made the following statement:

We welcome the opportunity to decide on the specific modalities for the new compensatory and contingency financing facility. For clarity and to reflect the structure of the facility, we suggest that, henceforth, the two types of financing be referred to as "compensatory financing" and "contingency financing," and not as compensatory financing facility and external contingency mechanism financing. In addition, we hope that today's discussion will permit the Board to establish the new facility by the middle of July, as suggested by the Managing Director.

The new facility contains a number of innovations and will have to be implemented on a somewhat experimental basis. Therefore, we need to have flexibility built into the modalities. Nonetheless, we believe that there is a need to establish some guidelines from the outset. This is to ensure uniformity of treatment of members, to provide a degree of certainty to borrowing countries about the circumstances in which the facility can be used, and to facilitate, simplify, and expedite negotiation of individual requests for compensatory and contingency financing facility financing. We recognize that it will be necessary to conduct a review of the operation of the compensatory and contingency financing facility no later than in one year's time. In the meantime, we would expect staff to bring to the Board's attention any specific implementation problems which arise.

We can support the basic approach contained in the staff paper (EBS/88/100), as well as the specific proposals, subject to the comments and alternative proposals which follow.

First, on the operational modalities for contingency financing in the compensatory and contingency financing facility, we believe that a common threshold for activation of contingency financing should be established. The purpose of a threshold is to avoid activation of the facility for inconsequential external developments, not to reduce the amount contingency financing potentially available. We would suggest that the Board consider 10 percent of quota as the initial threshold. Use of a percentage of quota is motivated by the need for uniformity of treatment and for simplicity. Also, use of Fund quota as the base, rather than GNP, seems more appropriate in that quotas are more directly relevant to a country's potential financing needs. Once it has been established that the size of the deviation from the baseline exceeds the threshold--and other conditions have been met--the borrowing country would be eligible for contingency financing. The amount of the potential financing available should not, in our view, be affected by the threshold. In other words, the threshold should not be deducted from the total deviation in determining the amount of financing to be made available.

We agree that the ratio of potential contingency financing to the amount of financing of the arrangement should be set on a case-by-case basis, within the normal maximum of 70 percent of the amount of the arrangement.

We support the need for an appropriate mix between contingency financing and policy adjustment, but do not see the need for precisely defined partial financing limits. Such limits will be implicit in the decisions made to determine for each program the share of the external impact which is to be met with financing, and the share that is to be offset by additional policy adjustment. We must try to assure that contingency financing achieves the purposes for which it is intended, namely, to provide sufficient amounts of temporary financing to cushion the adjustment to adverse exogenous developments, avoid an interruption in a Fund-supported program and help a country to continue to pursue the objectives of the program. Adding another prespecified limit appears to us unnecessary, given the existence of two other access limits in this facility--the basic access limit of 40-65 percent of quota and the proportional financing limit of up to 70 percent of the arrangement. Also, the amount and duration of contingency financing are limited by the rebasing of the program, usually after 12 months.

We have some sympathy, in principle, with the staff suggestion that the amount of contingency financing might be scaled down over the course of the program. However, in a 12-month arrangement with a six-month review, the time period for doing so within the baseline period would be quite limited. Should there be a follow-on arrangement, consideration could be given to a lower financing limit. But, even then, the unpredictability of new exogenous developments suggests the need for some caution in scaling down the new limits.

We would support attempts to outline, in a general way at the beginning of programs, the basic policy areas which a borrowing country and the staff agree should be the focus for additional policy efforts in the event of an adverse external development. However, we do not consider it practical or appropriate to define precisely future adjustment policies in the overwhelming number of cases. Uncertainties about the nature, extent, and circumstances of exogenous shocks imply that prespecification would seldom be practical. Therefore, we would expect that decisions on policy adjustments would normally be made in connection with the review and the Board decision concerning activation of contingency financing. We do not support the use of lapse of time decisions in cases where any review by the Board seemed required. The lapse of time approach was not part of the consensus which emerged prior to the Interim Committee meeting. In such cases, the Board should formally consider the matter and can decide expeditiously. However, we do agree with the exceptional approach whereby the Board would simply be informed of activation where prespecification of the financing and adjustment mix could be done with precision. In such cases, the Board should be notified sufficiently in advance, and we would expect such cases to be very rare.

We do not wish to have all the variables chosen on a case-by-case basis, as suggested by the staff. Rather, we propose that the three standard variables--export earnings (based on export prices and export market growth), import prices, and interest rates--should be covered in every case. The addition of other variables, such as tourism and workers' remittances, could be decided on a case-by-case basis. There will be very few cases in which the three standard variables are not important and the Fund's policy on uniformity of treatment suggests the desirability of including them in every case.

On the issue of exogeneity, this is of course central to the basic rationale for contingency financing. The staff will need to find ways to determine as far as possible the extent to which developments are truly exogenous, while avoiding if possible complex complications of whether a development is outside the control of the member. The selection of the three standard variables should help to make this possible.

We consider coverage of interest rates to be a critical feature of contingency financing. However, we have sympathy for the concerns expressed by some Directors about coverage of interest rates, and are prepared to support the idea of a sub-limit on access for that purpose. Parallel financing from other creditors, both private and official, is very important to permit a sharing of the financing burden of unexpected world interest rate movements, and to avoid the appearance that the Fund is "bailing out" the banks. Therefore, we strongly urge staff to develop precise and practical suggestions for ways in which to obtain agreements on parallel financing with the banks and with official creditors, possibly including multilateral institutions. However, we do not think it is practical or appropriate to require, in every case, that parallel contingency financing be available in order for interest rate movements to be covered by contingency financing.

We support the idea of encouraging debtor countries to seek ways to hedge their interest rate risks but we believe that, at this stage, it would be premature to deduct the amount of risks which has been hedged from the amount of contingency financing.

Normally, we would expect the baseline period to be limited to 12 months. However, if the program, itself, were up to 18 months long, then the baseline could also reach that maximum length.

We do not believe it is necessary to make any special provisions for preserving access to contingency financing when an external shock occurs very late in a program. If the normal procedures do not, it practical terms, allow for access, then the baseline period is probably near its end. The appropriate response to the shock in such cases is to commence negotiation of a new program with a new baseline period, assuming that continued Fund financing of adjustment efforts is still justified. Of course, in the new program, what would have been contingency financing would be covered in the overall financing package for the new program.

In principle, we believe that arrangements under the structural and enhanced structural adjustment facilities should be eligible vehicles for contingency financing under the compensatory and contingency financing facility, although they may need to be modified to allow for phasing of contingency financing. We recognize that the financing terms of the compensatory and contingency financing facility are less concessional than those of structural and enhanced structural adjustment facilities financing, and questions could be raised concerning the ability of some borrowers under those facilities to service market-based credit. On the other hand, it is important that all members have potential access to contingency financing. Also, the use of contingency financing involving additional policy actions should strengthen the country's debt-servicing ability. One possible approach would be to finance the contingency financing for countries with arrangements under the facilities in question from a mix of ordinary and concessional (structural and enhanced structural adjustment facilities) resources.

Second, on issues related to compensatory financing, we support the avoidance of overcompensation where a shortfall purchase falls within the two-year projection period of an earlier purchase. We do not support the idea of a symmetrical upward adjustment in a second compensatory purchase because of undercompensation at the time of an earlier purchase.

The question of disbursement of compensatory financing at the time a stand-by or other Fund-supported arrangement is approved in principle does not appear very relevant, in light of our new application of the guidelines on cooperation for compensatory financing. For example, in the case of members with a good record of cooperation, the full 40 percent access under the compensatory financing window would be available without a program and, even for members with unsatisfactory records of cooperation, 20 percent of quota would be available on the basis of prior actions. Therefore, we do not support the idea of disbursing compensatory financing on the occasion of Board approvals in principle of programs. I would note that since 1984, in all four cases in which this situation arose, the Board approved the compensatory financing drawing only in principle, and compensatory financing disbursements were not made until definitive approval of the credit arrangement.

We can support the approach to cereal facility access identified as (ii) in the text of the staff paper (Alternative C in the Annex). This approach has the advantage of conforming to the consensus already reached on total access at 105 percent of quota and preserving access to the new contingency window, while allowing a member to choose between compensatory financing for export shortfalls or cereal import increases within the 65 percent limit for the compensatory window (including the optional tranche).

Finally, on relations between compensatory and contingency access, our understanding of the consensus reached on the compensatory and contingency financing facility was that the optional tranche of 25 percent could only be allocated fully against either type of financing. We consider this the preferred approach, but would be willing to consider the possibility of divisibility of the optional tranche if others have a strong interest in this. In any case, the allocation of optional tranche financing should apply for the full length of the arrangement.

In line with our earlier suggestion that, at the time of creation of a contingency financing facility, all member

> countries should have initial access to this new type of financing, we are willing to go beyond the staff proposal on transitional arrangements to allow for initial access of up to 40 percent of quota, regardless of the amount of compensatory financing credit outstanding at the time of initiation of contingency financing. This could result in a temporary increase in total access under the new facility of up to 123 percent of quota (for countries which have completely exhausted the old limit of 83 percent of quota on access). However, with repurchases of outstanding compensatory financing credit, such countries' access limits would decline until they reached the new standard overall limit of 105 percent of quota.

Extending his remarks, Mr. Dallara said that he hoped Directors would follow the Chairman's suggestion that the guidance provided by the Interim Committee be regarded as a basis for proceeding, with those elements agreed upon by the Interim Committee no longer to be considered. Only the technical details should now be discussed.

With respect to Mr. Ortiz's suggestion that arrangements under enhanced surveillance be eligible for contingency financing, Mr. Dallara indicated that he would like to return to that issue after listening to the comments of other Directors.

While he had been content with the staff proposal on transitional arrangements for the compensatory financing facility, Mr. Dallara said that he was willing to listen to the concerns of other Directors before reaching a definitive position.

He could associate himself with Mr. Ortiz's comments on interest rate coverage, Mr. Dallara concluded.

Mr. Kafka said that, on the staff proposal for transitional arrangements, he considered it improper to ask the Board to agree to a change in access on June 17 in a paper that had been circulated only on June 14. In addition, it was not clear how one would define cases in which discussions on compensatory financing had already begun. He considered that the procedure outlined in his statement would be preferable.

Mr. Nimatallah said that he welcomed Mr. Dallara's suggestion that, for the transitional period, all members would be granted 40 percent access to contingency financing, regardless of their outstanding purchases under the compensatory financing facility. He agreed with the staff that a specific deadline had to be set, after which there would be a shift from the compensatory financing facility rules to the new rules of the compensatory and contingency financing facility. However, he took Mr. Kafka's point that it might be preferable to make clear in advance which members were considered to have entered into discussions on compensatory financing.

Mrs. Ploix made the following statement:

Let me emphasize the great importance that this chair attaches to this discussion. The implementation of the compensatory and contingency financing facility is a very complex matter, and its successful functioning requires careful attention. The paper before us is very helpful in this regard; it offers a straightforward and comprehensive review of the problems involved. It will deal successively with the issues and proposals related to the external contingency mechanism, compensatory financing facility, and the relation between them.

Before addressing the issues raised by the staff, I would like to briefly touch upon my major concerns about the implementation of the external contingency mechanism. We should strive to implement as simple a mechanism as possible, avoiding the risk of arbitrariness by designing clear guidelines that are consistent with Board practice. We should make sure that this new mechanism will not lessen the need for adjustment. More generally, we should probably implement it cautiously on an experimental basis, given that all new mechanisms require a breaking-in period.

I would now like to comment on the following issues. As regards access, we consider that contingency financing for an individual arrangement should not exceed 70 percent of access under the associated arrangement. Concerning the distribution of contingency financing within a multiyear arrangement, it seems to me that we should avoid too rigid an approach consisting of tightly linking the annual amount of contingency financing with the annual amount available under the associated arrangement. I do agree that it is important to ensure the availability of the Fund's contingent support throughout the period of the arrangement; however, such an approach could result in inadequate financing. I therefore fully support the possibility of establishing front-loading contingency access and carry-over of unused access to later program years.

As far as the minimum threshold is concerned, I would prefer to set a common threshold, since we have to avoid arbitrariness; I would suggest that this threshold be expressed as a proportion of GDP, which would reflect the real economic situation more effectively than a percentage of quota. I have no precise figure in mind; perhaps in could be set close to the middle of the range that the staff suggested in its statement on the design of contingency mechanisms. I recognize that it is probably difficult to set a specific threshold but in any case, we should decide upon a narrow range with precise guidelines. I must confess that, in this regard, I am not fully convinced by the guidelines suggested in the staff paper (EBS/88/100).

Indeed, at first sight, one could say that members' susceptibility to external shocks should be widely taken into consideration; however, one could also argue that such an approach is not an incentive for members to reduce their external vulnerability. Likewise, the room for maneuver that may exist within the program is not necessarily relevant, to the extent that such reasoning is likely to penalize countries with a good track record to benefit countries with unsatisfactory records of cooperation.

Let me also ask the staff to confirm that the amount of the threshold should not be deducted from the total deviation in determining the amount of financing to be made available. The threshold must simply work as a de minimis limit for activating the facility.

I would have liked the staff to be more explicit on the proportion of the contingency to be financed. We strongly believe that a precise range associated with clear guidelines is necessary, and consider it crucial to pay close attention to finding an appropriate mix of adjustment and financing in setting up these guidelines.

We strongly believe that the features of the external contingency mechanism attached to individual arrangements should be specified in advance and as clearly as possible. Such an approach is the best suited to giving members confidence while avoiding the risk of arbitrariness. Designing the precise triggering mechanism at the same time as the program would ensure that there is an appropriate mix of adjustment and financing and would facilitate the phasing in of adjustment measures. I therefore agree with the staff that at the outset of an arrangement, we should always strive to specify maximum access; provisions relating to activation, symmetry, and phasing; the exogenous factors to be covered; the corresponding baseline scenarios; the threshold; and the general approach to calculating contingent deviations; as well as a clear indicator of the nature of the appropriate policy responses in the event of adverse shocks.

On coverage, I have no difficulties with the staff's proposals. Indeed, it seems fully justified to rule out the coverage of capital movements given the impracticality of assessing whether or not such movements are beyond the country's control. It is also clear that it would be dangerous to compensate shortfalls in foreign financing specified in the program, since that would give rise to inappropriate incentives to the international financial community. I can support the coverage of interest rates; however, we must bear in mind that such coverage could imply a substantial cost for the Fund. Moreover, one could argue that coverage of interest rates could give the impression that the Fund is ready to assume a responsibility that is actually that of the whole international financial community. Furthermore, one cannot rule out the influence of interest rate contingencies on lending and borrowing behavior. In light of these considerations, I agree that this coverage should be subject to a specific limitation; 35 percent of quota seems to us to be a maximum. I also agree that an external contingency mechanism covering unforeseen developments in interest rates should imply that creditor banks will also provide parallel contingent financing or other equivalent contingent support.

I can go along with the principles proposed by the staff with regard to the calculation of contingent deviations. I cannot but reiterate that, in my view, the quality and accuracy of the baseline scenario is one of the most important elements for the success of this new mechanism's implementation. This scenario must be indisputable. I consider that the reliance on world economic outlook projections is crucial in this regard. The selection of the variables should fully take into account the availability of adequate and objective corresponding data.

It is essential that the Board have the final word on the conditions and granting of an external contingency mechanism. Indeed, the Board must be clearly involved in this intricate process. Consequently, simply informing the Board after an external contingency mechanism has been granted is not acceptable. I would also be very reluctant about the possibility for the Board to decide on a lapse of time basis.

I have many questions on phasing. I understand that the initial purchase under an external contingency mechanism would be made available when the cumulative deviation was projected to exceed the threshold. Does this mean that this purchase would be made before the actual shortfall is ascertained? What would be the procedure for the remaining purchases? Would all the purchases have to be equal? What would be the criteria for ending contingency financing? With such phasing, would we not be running the risk of providing inadequate purchases? Would it be possible to implement front-loading?

To provide multiyear arrangements with the same flexibility as one-year stand-by arrangements, the staff notes that ad hoc augmentation of access might be possible. Does this mean that these arrangements could be lengthened in order to allow countries to make external contingency mechanism purchases? It would not be advisable to artificially extend the program period in the event of "late" shocks; indeed, either the shock is small and should be absorbed by the member country, or it is large, in which case a new arrangement would probably be necessary. Finally, I would appreciate it if the staff could elaborate further on how performance criteria would be revised.

I can only be in favor of establishing symmetry, but I would like to stress the importance of clear guidelines for its implementation. We can anticipate some reluctance on the part of certain countries and we should be vigilant in this matter. I would like some clarification from the staff on this point.

Concerning arrangements eligible for external contingency mechanisms, it goes without saying that the external contingency mechanism should be linked to arrangements under the enhanced structural adjustment facility; indeed, countries eligible for such arrangements are more vulnerable and often heavily dependent on a few commodities. Moreover, we think that it is perfectly normal to use the Fund's resources to protect the functioning of the enhanced structural adjustment facility. In this same vein, the external contingency mechanism should also be available for countries with arrangements under the structural adjustment facility. We have always strongly argued for the additionality of the structural adjustment facility and the stand-by arrangement. However, there is an unfortunate tendency to exclude countries under the structural adjustment facility from receiving stand-by arrangements. Excluding these countries from the external contingency mechanism would penalize them even more, as including arrangements under the enhanced structural adjustment facility seems to be difficult for some of them.

I agree that the Fund should use contingent financing to strengthen its catalytic role and to promote contingent support from other sources, provided that is does so in a flexible manner and does not lead to undue delays.

I would remind you that this chair has always emphasized the usefulness of the compensatory financing facility and that it is crucial to preserve its essential features. Consequently, we accepted the April compromise with some reluctance, to the extent that it brought about a considerable decrease in compensatory financing access and established a new tranching which is likely to make the compensatory financing facility less attractive and less efficient. We therefore think that we should strive to maintain its basic features in the new framework.

I now turn to the staff proposals. We fear that the first tranche is too small. Since conditionality will be tightened, it would make the compensatory financing facility less attractive; we would therefore have preferred the first tranche to be at least 25 percent.

As far as the guidelines on cooperation are concerned, I would like to make sure that consistent with my understanding of the Chairman's informal remarks, at Informal Session 88/5 (4/7/88), a Fund arrangement would not be a prerequisite for access to the optional tranche for a country with a good record of cooperation. As regards countries with bad track records, I understand that a Fund arrangement would not always be required for the second tranche, provided that the Fund is satisfied that equivalent requirements have been met. Therefore, I find it somewhat contradictory that use of the optional tranche is dependent upon the satisfactory completion of a review of the Fund arrangement; would it be possible to use the optional tranche only on the adoption of a Fund arrangement? Would it also be possible to draw 65 percent immediately upon the satisfactory completion of a review? I would also like to stress that in my understanding, Fund arrangements clearly include those under the structural and enhanced structural adjustment facilities. Let me further point out that an arrangement approved in principle would meet the test of cooperation.

I can go along with the staff's proposals with regard to the application of a projection limit and the adjustment for overcompensation.

As regards the cereal decision, we favor option (iii) mentioned by the staff.

I agree that the optional tranche should be completely divisible but I think that countries should be able to make a choice on use of the optional tranche at any time and not only at the start of an arrangement with an external contingency mechanism. We fear that such a possibility could be detrimental to the compensatory financing facility--the cereal facility is a good example in this regard. I am not fully convinced that lack of a prior commitment would create uncertainty. Indeed, we consider that maximum flexibility is required to ensure adequate financing when needed.

With respect to procedures for avoiding possible double compensation, I can go along with the staff proposals, but I am afraid that there will be considerable technical difficulties involved in such endeavors.

Extending her remarks, Mrs. Ploix said that her authorities felt strongly that the structural adjustment facility should be considered eligible for contingency financing; they did not agree with the staff that that would be overly difficult.

On compensatory financing, a first tranche of 20 percent for second category countries--those with a poor record of operation--was too small, Mrs. Ploix indicated. Since conditionality of compensatory financing would be tightened, the first tranche should be at least 25 percent of quota. On the guidelines for cooperation, she had a number of questions for the staff, since her understanding of the Chairman's informal remarks on April 7 (see IS/88/5, 4/7/88) had not been accurately translated into the staff paper.

The optional tranche should be completely divisible, and member countries should be able to make a choice on the use of that tranche at any time, and not only at the start of an arrangement using contingency financing, Mrs. Ploix stressed.

A review of the new facility should be conducted in about one year, so that the Board could reflect on the facility's operation on the basis of experience, Mrs. Ploix concluded.

Mr. Sengupta indicated that he agreed with Mrs. Ploix that the first tranche of the compensatory window should be set at at least 25 percent.

Mr. Yamazaki made the following statement:

> I welcome this continuation of our work on the compensatory and contingency financing facility, which the Interim Committee requested the Executive Board to complete expeditiously. At the outset, I would like to reiterate the importance that my authorities attach to implementing, at the earliest possible date, this new facility. The facility will no doubt strengthen the adjustment process by providing confidence to members with Fund-supported programs through contingency financing as well as compensation of export shortfalls. My authorities believe that the effective establishment of this new facility will contribute to the further evolution of the debt strategy.
>
> Since I found the thrust of the staff paper appropriate, I do not have much to add, but I would like to stress some concerns of my authorities on the specific issues raised, and to present our view on the issues left open by the staff.
>
> First, my authorities are concerned about the limited experience of the Fund with some features of the contingency element. I, therefore, would endorse the staff's proposal to proceed with the operational modalities of the contingency element on an experimental basis and to avoid predetermining rigid guidelines. We should begin operation of the new facility with adequate flexibility, and allow appropriate guidelines and practices to evolve on the basis of the experience that we will acquire from individual cases. In any case, we should not delay the completion of our work by seeking excessively detailed and complicated guidelines.
>
> Second, my authorities are concerned that rigid operation of the facility might reduce its effectiveness in providing confidence to members with Fund-supported programs. Therefore, I would underscore the need to take a flexible approach on the

contingency element's access and financing limits for the contingency element. In this context, while I would support a proportional financing limit that was normally within 70 percent of the access under the associated arrangement, we should be flexible in that regard. We should also take a flexible approach in allowing front-loading or carry-over of annual contingency access in multiyear arrangements.

While we are not in favor of a subceiling on the interest component in addition to the access limits and financing limits of the contingency element, we are prepared to go along with its establishment in order to mitigate the concerns of other Executive Directors about the coverage of interest rates by the new facility.

I do not consider that only a proportion of the contingent deviation should be financed, nor do I think the threshold should be deductible from total contingency financing.

Since the compensatory and contingency financing facility should give confidence to members, I would associate myself with Mr. Dallara's proposal that, in the transitional phase of the new facility, contingency financing of 40 percent of quota be allowed regardless of the compensatory financing facility purchases outstanding, to the extent that this does not contradict the uniformity of the treatment of members. I would welcome the staff's comment on this point, especially from the legal standpoint.

I would want arrangements under the structural adjustment facility to be protected by the contingency element, and propose that such arrangements should be considered eligible for compensatory financing, if the member agrees to strengthen the monitoring process.

Similarly, I would support the staff proposal to make the optional tranche divisible, although, on this issue, I am ready to go along with the majority.

Another concern of my authorities is that the complex features of the contingency element might unduly delay the negotiation of an arrangement, as well as postpone the activation of contingency financing. Although I would support the staff's proposal to bring to the Board an indication of possible policy responses to adverse developments, this requirement should not delay negotiations between the staff and the member country.

Transparency of procedures should be ensured. I therefore support the proposal that the contingency element cover the deviation of a few key external variables--export earnings, import prices, and interest rates. Tourist receipts and migrant workers' remittances could also be covered in exceptional cases.

I am not in favor of the proposal to require parallel contingency financing by private banks for the coverage of interest rate movements by the facility. This requirement could unduly delay the activation of the external contingency mechanism.

I will now take up a few issues left open by the staff. First, on the cereal decision, although I do not have a definite view, I would tentatively support a joint limit for export shortfalls/cereal excesses of 82 percent of quota, so as to make the new facility compatible with the existing system.

Second, I do not support the view that an arrangement approved in principle would meet the test of cooperation for a compensatory financing purchase.

In conclusion, I hope that we can expedite our work on this issue, in order to pave the way to a smooth and effective start of the compensatory and contingency financing facility.

Mr. Abdallah made the following statement:

Contingency financing represents a welcome departure from existing practices governing Fund assistance for adjustment programs. It is an idea born out of experience--the recognition that external shocks have the potential to derail adjustment programs, even when the domestic authorities have demonstrated a clear commitment to the pursuit of sound economic policies. In such circumstances, the ready availability of additional financing could make a difference, not only by keeping the adjustment process on track but also by keeping it within the realm of what is feasible given the social, political, and institutional constraints that help determine a country's capacity to adjust.

Like the compensatory financing facility, the external contingency mechanism's effectiveness will depend on the timeliness of disbursements. To be sure, the emphasis cannot be placed on financing alone; adjustment must remain paramount. The Fund will have to take an eclectic view toward compensatory financing, gathering experience as it goes along. We need to start with a broad outline of precise criteria that can be applied uniformly to all members, and to ensure that operational procedures will be simple in order to avoid protracted delays in both negotiation of the initial programs and in their activation, should a contingency arise. I have a real concern about the latter, because some of the key operational features proposed by the staff give the impression that an attempt is being made to devise two programs simultaneously, with the contingency-linked program determining the basic features of the underlying arrangement.

I appreciate the fact that broad parameters must be established for contingency purposes, but it is also clear that it is difficult, if not impossible, to plan in detail for unforeseen shocks that an economy might experience. This underscores our objection to linking the activation of external contingency mechanisms to elaborate reviews and associating disbursements with purchases under existing programs subject to observance of performance criteria. I strongly believe that such procedures will undermine attainment of the external contingency mechanism's intended objectives.

For operational purposes, it must be accepted that some exceptionally large external shocks might be dealt with more appropriately in the framework of a new arrangement. However, these should be rare cases. Otherwise, the incorporation of an external contingency mechanism in an adjustment program that is intended to deal with uncertainties might itself become a source of uncertainty. Members should enter into an arrangement with a minimum level of assurance that the agreed contingency financing will be forthcoming should they be confronted by unforeseen shocks.

I agree with the staff proposal that access limits under the external contingency mechanism be outside those specified under the policy on enlarged access and that they be independent from the reserve position of a member. It is important that the Fund's contingency financing be available throughout the period of the arrangement. However, it might not be a good idea to maintain rigid annual apportionments. Quite often, countries tend to have a more difficult time keeping programs on track at the initial stage when greater financial resources are required. This has been one of my concerns with back-loading in some Fund-supported programs. The Fund should therefore maintain a flexible approach regarding the annual distribution of contingency financing in multiyear arrangements.

Regarding thresholds, I note the staff suggestion that countries experiencing more frequent shocks should protect themselves by building margins of protection into the design of Fund-supported programs. A basic question is, what does the staff intend to do to improve program design so that protective margins perform as expected? It is well known that unexpected shocks have tended to disrupt program implementation frequently. In view of this, I cannot help objecting to the two last sentences in the second paragraph of page 5 of the staff paper: "As an example, an economy with a relatively large but undiversified external sector may be relatively more subject to external shocks, and in such cases appropriate margins should be incorporated into programs. External contingency mechanism resources should be committed only for protection of disruptions beyond those that can be absorbed by program margins, implying a relatively high threshold." That observation appears to suggest that those countries that are most susceptible to external shocks would benefit least from the contingency facility. If this is the case, low-income countries in particular would be constrained in their use of the facility by a high threshold. I would be unable to agree to any proposal that would place a considerable portion of the membership at a disadvantage.

The three key external variables to be covered by compensatory financing, as proposed by the staff, exclude two major exogenous factors that have adversely affected Fund-supported adjustment programs in many low-income countries, namely, shortfalls in external financing and cyclical changes on the supply side caused by factors such as drought and locusts, which are now raging over Africa. I am aware of the problems the Fund might have in covering shortfalls in external aid, but the reality is that problems of this nature have tended to aggravate the burden of adjustment and to disrupt Fund-supported programs in many countries. Since it is suggested that interest rates be included as one of the variables to be considered--and I support this--I see no reason why the impact of natural calamities should not also be included in more specific terms. While the effect of drought is dealt with to some extent through the coverage of export shortfalls or cereal imports, I think a more direct recognition would be helpful.

The Chairman noted that the coverage of shortfalls in external financing could actually lead to an increase in such shortfalls.

Mr. Abdallah indicated that his concern was for low-income countries with official aid flows that were delayed but would eventually be forthcoming.

Mr. Abdallah then continued his statement:

I am not convinced that contingency financing should be withheld if a problem develops late in the course of an annual program. With regard to the proposal to extend the annual baseline projections for six months--at the request of the authorities--for the purpose of activating contingent financing, it should be indicated that the Fund will be prepared to increase financing appropriately during this period to help sustain and even strengthen the adjustment process.

On the concept of symmetry, I see its application as a natural extension of the contingency framework. However, symmetry should not be an end in itself. Gains resulting from favorable developments could be used to increase reserves, or to support higher levels of investment and growth. I do not agree that financing under an arrangement should be reduced because of unexpected favorable gains, since such gains tend to be only temporary. Moreover, they are usually small in relation to the amount of financing required to support a sustained adjustment effort. If the gains are large and sustainable, I would not have any problems with the application of the principle of symmetry.

I fully endorse the view that contingency financing should be incorporated into arrangements under the structural adjustment facility. In this connection, I would seek the staff's reaction to the possibility of providing such financing on terms similar to those of the enhanced structural adjustment facility or with a mixture of concessional and ordinary resources as suggested by Mr. Dallara. The staff should explore the possibilities further.

The proposal to make Fund contingency financing conditional on similar arrangements with commercial banks might make the new facility effectively unusable, because recent experience has not shown commercial banks to be particularly cooperative where new money is involved. As beneficiaries of higher interest charges, banks should be made to contribute to the financing, but requiring this could cause such delays as to derail the adjustment process.

Turning now to issues relating to the compensatory financing facility, I recall that most Executive Directors have stressed the need to maintain its essential features. Two such features are the timeliness of disbursements and relatively low conditionality. The essential question is how to preserve these features when the combined facility becomes operational. Division of the 40 percent compensatory component into two equal portions for those members with unsatisfactory records is already highly restrictive. Let us not aggravate the position by adding further complications.

I consider arrangements under the structural and enhanced structural adjustment facilities as fully satisfying the test of cooperation under the 1983 guidelines; these guidelines do not strictly require an approved Fund-supported program. As for the compensatory financing requests made during the course of arrangements under the structural adjustment facility, my position coincides with the staff proposal--that the purchase be based on an ad hoc review of the arrangement. On the issue of approval in principle, I will only restate my earlier position that an arrangement approved in principle would fully meet the test of cooperation for a purchase.

As regards the joint limit for export shortfalls and cereal excess, I support the proposal of a higher overall ceiling that would preserve the external contingency mechanism element at 40 percent and raise the combined limit beyond 65 percent to at least 83 percent.

On the relationship between the compensatory and contingency elements, members should have the right to decide on the split of the optional tranche that is most suitable to their needs. I therefore do not support the staff proposal that a member be required to determine how it intends to use the optional tranche at the start of an arrangement that incorporates contingency financing. Any restriction on this aspect of the combined facility will introduce unnecessary rigidity into a process that is best served by innovativeness and flexibility.

As for the transitional procedures proposed in the staff statement, my inclination would be to allow discussions under the existing compensatory financing facility to proceed in the normal manner until the new facility comes into full operation. I do not agree that June 17 should be considered a cut-off date for commencing discussion under the existing compensatory financing facility. I also do not favor the three-month limitation for conclusion of ongoing discussions, because technical reasons or other factors beyond the authorities' control could cause delays.

Mr. Reddy made the following statement:

Since there are many features on which there is a broad consensus, I propose to address only the remaining issues, in the same order as they appear in the summary of the staff paper.

My views on the modalities of the external contingency mechanism are guided mainly by the consideration that external contingency mechanisms must provide a firm assurance that contingency financing will be available under certain circumstances. This assurance is essential to give members the necessary confidence to undertake and persist with adjustment in an uncertain external environment, including uncertainties about financing from private sources. Therefore, the modalities should be designed so that Fund contingency financing is assured over a broad, but reasonable, range of uncertainties faced by members.

In this light, I can broadly agree with many of the modalities proposed by the staff. In particular, I support the floating of contingency purchases in the reserve tranche, as well as the proposal to consider contingency access as falling outside the limits specified under the enlarged access policy.

Let me now turn to those proposed modalities with which I have some difficulty. The proposal to divide available contingency financing into annual portions under a multiyear arrangement could lead to very different solutions for the same contingency, depending on the life of the associated arrangement. Differences could arise, for instance, with respect to actual access as well as the judgment on whether there was a need for a new arrangement.

Let me explain myself by presenting an example. A country with a quota of SDR 50 million and a four-year extended arrangement of 100 percent of quota would receive contingency financing of only SDR 8.1 million a year if the external contingency mechanism disbursement were phased equally over a four-year period. In contrast, if the same country had a one-year arrangement, it could get an annual access of SDR 32.5 million. In another example, let us assume that the same country with a four-year arrangement incurred a contingent financing need of SDR 20 million because of adverse exogenous factors. Since the external contingency mechanism would finance only one quarter of the additional deficit in the first year, there would remain a large financing gap in the absence of additional financing from other sources. This large financing gap could easily lead to a judgment that there exists an "exceptionally large shock," which requires a completely new arrangement. In contrast, if the same country had a one-year arrangement, the additional deficit could be considered as readily financeable because of the larger contingency access under a one-year arrangement.

In order to prevent the problems of the type I have just mentioned, and to avoid creating an incentive for countries to opt for one-year arrangements when multiyear arrangements may be more suitable, I would suggest the following two courses of action. First, there should be a front-loading of contingency access in multiyear arrangements. I would suggest that at least one half of the maximum contingency access--namely, 32 percent of quota--be made available in the first program year under multiyear arrangements. Second, the staff should pay due regard to the differences in access under single-year and multiyear arrangements when determining the threshold for activating the external contingency mechanism and the proportion of contingencies to be financed on a case-by-case basis. For this purpose, the threshold may be established as a range, say 5-10 percent of quota, and flexibility may be provided within this range.

Turning now to the question of coverage under the external contingency mechanism, I would strongly urge that the debt service consequences of large swings in exchange rates of the major currencies be covered under the external contingency mechanism. In recent years, this element has been as important as increases in world interest rates in raising the debt service burden of many countries. It would therefore be only logical to provide assistance to members to deal with this problem.

While I am on the subject of coverage of the external contingency mechanism, the proposed treatment of deviations in interest costs is difficult to justify. The staff is suggesting that interest rates not be covered until parallel contingent support is arranged, and that an external contingency mechanism not be activated until the critical mass of contingent financing is secured. These proposals may totally negate the usefulness of the external contingency mechanism, given the very difficult circumstances faced by many debtor countries today. Besides, the rationale for such proposals is weak. The argument that debtors can hedge their risks in world financial markets could be equally applicable to the case of commodity prices, but deviations in commodity prices are fully covered. Similarly, a critical mass of parallel contingent financing could also be required for deviations in, inter alia, export earnings, import prices, tourist receipts, but is not being insisted on for those variables. I would therefore suggest that deviations in interest costs also be exempt from the requirement of parallel contingent support.

With regard to parallel contingent financing from commercial banks, this should not be a requirement in all cases, given the difficulties in arranging even the basic financing packages. In cases in which contingency financing requirements are small, the Fund should avoid the time-consuming procedure of finding parallel financing and should provide financing on its own up to the access limit. I could support the approach of soliciting contingent support from other creditors on a case-by-case basis only where the need for contingent financing is large and where minimum delays can be expected in getting support for parallel financing.

The external contingency mechanism depends critically on world economic outlook baseline projections. At present, we follow a prudent approach under which future interest rates, exchange rates, and commodity prices are assumed to be constant in real terms. Under the staff proposal, these nominal values will now have to be projected. This would be a very difficult and risky departure from the current practice, and I am not sure whether it would be prudent of the Fund to take this approach. The world economic outlook projections of interest rates, exchange rates, and commodity prices could affect expectations in the markets and accentuate market volatility. There may well be unintended repercussions in global financial and commodity markets as a result, especially if the Fund were to encourage countries to hedge their interest rate risks. For example, what would happen if all debtor countries were convinced that London inter-bank borrowing (LIBOR) rates would rise and wanted to hedge their risks at the same time? I would request the staff to give more thought on this matter.

With regard to access under the compensatory element, my strong preference is for the first tranche of that element for members with less satisfactory records of cooperation to be 25 percent of quota, so that there is an element of front-loading.

I continue to hold the view that an arrangement approved in principle meets the test of cooperation for a compensatory financing purchase. Nevertheless, I am prepared to accept a compromise that would permit an outright compensatory financing purchase of the first tranche of the contingency element for arrangements approved in principle.

On the cereal decision, my preference is for option (iii) listed by the staff on page 21 of EBS/88/100. I am convinced that a higher overall ceiling would best serve the objectives of the compensatory financing facility, external contingency mechanism, and cereal decision. In this connection, Alternative B in the Annex would ensure symmetry of treatment for all three elements, and provide a more adequate overall access of 145 percent of quota.

Finally, on the relationship between the compensatory financing facility and the external contingency mechanism, I am not altogether convinced by the staff's reasoning that a member should make a binding choice at the beginning of the program on the proportions of the optional tranche to be assigned to the compensatory and contingency elements. I would prefer complete flexibility to be given to the member in using the optional tranche for either element.

With regard to the transitional provisions for use of the compensatory financing facility, I can accept the proposal that all discussions on compensatory financing facility be based on the new decision, but only after the date on which the Board has agreed on the new decision, which I hope will be very soon. As a transitional arrangement, I can also support Mr. Dallara's suggestion that initial access of up to 40 percent of quota be allowed regardless of the amount of compensatory financing facility credit outstanding at the time of the initiation of contingency financing.

Mr. Cassell said that he wholeheartedly agreed with the staff's points that "it would seem advisable to proceed in many areas on an experimental basis" and that the Board should "bear in mind the necessity of keeping procedures as simple and transparent as possible." While it would not always be easy to achieve the latter objective, it should be a goal of the Board to create a facility that was simple enough to be readily understood by members seeking assistance.

In building the new facility, the objective of the contingency element to reinforce orderly adjustment should be kept firmly in mind, Mr. Cassell stressed. That objective was set out in the principle that there should be an appropriate blend of adjustment and financing. Contingency financing should therefore be regarded as having two triggers: an unanticipated external development, and the implementation of necessary additional policy measures.

Contingency policies should be clearly prespecified whenever possible, Mr. Cassell continued. To the extent that that could be done, the areas for discussion in the context of contingency financing could be narrowed, and it might, on occasion, prove possible to allow lapse of time decisions, with specific policies serving as prior actions. That possibility raised difficult issues, and the staff would have to clarify its proposed procedures. It would be essential to avoid creating undue expectations, and adequate notice would have to be given to the Board. Most likely, such streamlining would only prove possible in practice when a single variable was covered, as in the Mexican case.

There was a difficult balance to be struck between avoiding undue expectations and granting a country confidence that appropriate support would be forthcoming if its balance of payments was set off course by exogenous factors, Mr. Cassell observed. Achieving that balance would entail an adequate degree of contingent conditionality. As a general rule, it would be wise to rely on reviews, which allowed the necessary judgment to be exercised prudently.

He was broadly content with the staff proposals on access, Mr. Cassell indicated.

On the minimum threshold to be applied before access to contingency financing was allowed, Mr. Cassell said that he favored measuring the shocks in terms of a composite and widely accepted standard, such as the country's Fund quota. A common level would be preferable, but a case-by-case judgment within a given range might be necessary. The level of the threshold should be set primarily on de minimis grounds, to exclude inconveniently small requests. The effects of the shock below the threshold should also be eligible for financing.

On the coverage of contingency financing, he continued to favor concentrating on a small number of preselected and inherently exogenous variables such as export earnings, import prices, and nominal interest rates, Mr. Cassell said. Such a focus would greatly simplify and expedite contingency financing. Gradual broadening of coverage should be done cautiously, and priority should be given to the more volatile components of the country's current account. He agreed with the staff that the selection of variables for a particular country should be relatively stable over time.

He firmly supported the inclusion of interest rates in the variables to be covered, Mr.Cassell indicated. However, he accepted the need for some caution. Where possible, the staff should strongly encourage hedging, using market mechanisms. He looked forward to the staff paper on that subject; there might be potential to bring the commercial banks into a parallel relationship in that context. In the meantime, however, he would not favor a firm requirement for parallel contingency financing from the banks or other sources, although he would press for such parallel financing in particular cases where such contributions were feasible.

If changes in net interest payments were to be calculated from a benchmark international interest rate, such as the LIBOR, and applied to an aggregate debt figure, great care would have to be taken to account for fixed interest and concessional debt, Mr. Cassell remarked. He assumed that there would be no danger of compensating for interest payments in arrears, but, as a general safeguard, the staff might investigate the possibility of some ex post adjustment to ensure that calculated deviations were not significantly different from actual outturns in net interest payments.

He continued to attach great importance to the concept of symmetry, Mr. Cassell said. On the question of how the benefit from favorable development should be directed, his first preference would be for early repurchase of previous contingency financing, because such financing should revolve as rapidly as possible in order to maximize available access at any one time.

He had doubts about using the new facility with arrangements under the structural or enhanced structural adjustment facilities, Mr. Cassell commented. He did not rule out contingency financing for those arrangements altogether, but would prefer that it be limited to cases in which the extra cost of ordinary resources would not impose an undue burden on the borrower. Those facilities were concessional for a particular reason, and his authorities remained doubtful about the wisdom of diluting their concessionality. That had occasionally been inevitable because of the limited resources of the structural adjustment facility, but he was not convinced that that was the case with the enhanced structural adjustment facility, particularly given its emphasis on reinforcing reserves, which should provide greater inherent robustness. The enhanced structural adjustment facility also had sufficient flexibility in terms of annual access to take account of external developments. However, if the Board wished to provide contingency financing with the structural and enhanced structural adjustment facilities, more appropriate mechanisms should be investigated, preferably financed wholly or partly with concessional money. Mr. Dallara and Mr. Abdallah had put forward suggestions along those lines, and he would certainly support those proposals being followed up.

On the compensatory element of the new facility, he had been working on the assumption that the 40 percent access would be divided equally into two tranches, Mr. Cassell commented. His authorities continued to believe that the compensatory access above 20 percent of quota should not be granted when the associated arrangement was approved only in principle. However, approval in principle was clear enough evidence of a country's intention to cooperate with the Fund to allow first tranche access.

On the cereal facility, he could to along with Alternative A or C outlined by the staff in Annex I, Mr. Cassell said, but not with Alternative B, which built in unnecessary access for a facility that was underutilized as it was.

He had no strong views on the question of the optional tranche's divisibility and could go along with the Board's consensus, Mr. Cassell remarked. In earlier discussions, Directors had placed considerable emphasis on fungibility. For that reason, he considered that the choice of use should remain binding for the period for which the baseline had been established, but again, he did not feel strongly about that issue.

On the transitional arrangements, he also had no strong views, although he had been content with the staff proposal, Mr. Cassell indicated.

The proposal of Mr. Ortiz that enhanced surveillance arrangements be eligible for compensatory financing seemed to complicate the modalities of the new facility, Mr. Cassell commented. In addition, there did not appear to be a clear time period for arrangements under enhanced surveillance, which meant that the compensatory financing arrangement would be rather open ended in terms of time.

He had questions about the method of adjusting for double compensation between the compensatory and contingency elements of the new facility, Mr. Cassell said, but as those were technical, he would put them to the staff bilaterally.

He hoped that the Board could build on the consensus achieved before the Interim Committee meeting and endorsed by that Committee, and have the compensatory and contingency financing facility in operation very quickly, Mr. Cassell concluded. He had great hopes that the new facility could make a major contribution to sustained adjustment and to the public perception of the Fund's role in that process.

Mr. Ovi made the following statement:

> Let me first reiterate my support for the compromise that was achieved in this Board in April. It is important to recall

that in order to reach this agreement, each of us had to make some concessions on the structural framework for the compensatory and contingency financing facility. Like several of my colleagues, I still have reservations on some of the modalities, but I strongly believe that we should now avoid a reopening of our previous discussion on the principles for the new facility.

With this in mind, I can, to a very large extent, subscribe to the views and suggestions presented in the staff paper before us. The staff has, indeed, provided a solid and comprehensive analysis of the remaining questions regarding operational modalities. Before commenting on some of the more specific issues, I should like to make a few general remarks.

First, I would like to emphasize the importance my authorities attach to the establishment of operational modalities that are both simple and transparent. We should be very careful not to unduly increase the complexity of Fund facilities, which could severely complicate negotiations with prospective borrowers.

Second, we believe that it would be prudent to proceed rather cautiously in implementing the new features of the combined compensatory and contingency financing facility. Contingency financing as such is a new concept in the financial role of the Fund, and a number of new operational elements will have to be introduced. This calls for greater Board involvement in the first, more experimental phase. Accordingly, in this introductory phase, we see very little scope for activation of the contingency element without review in the Board.

Third, we favor an early review of the facility and its operations.

On contingency financing, I can support the proposed principles concerning access, including the suggested procedures for annual distribution of contingency financing in multiyear arrangements approximately in proportion to the corresponding annual access under the associated arrangement. I can also support the notion of thresholds and the proposal that the mix between adjustment and financing beyond the threshold be assessed on a case-by-case basis.

In the choice of thresholds, we are clearly faced with a trade-off between simplicity and flexibility. Although I understand the advantages of maintaining a flexible approach to take account of different balance of payments structures in member countries, I also believe this need should be balanced with the operational advantage of more standardized guidelines. I have particular difficulty with the notion that the threshold should be a function of a judgment on the room for maneuver within a given program, since this would penalize good performers. Also, in order to avoid the inconvenience of activating contingency financing caused by minor deviations only, I would, on balance, be in favor of a minimum threshold somewhat higher than what is implied by the staff statement on the design of contingency mechanisms. I would also be open to the idea of a common threshold. Only experience can show which approach is preferable. In any case, the threshold should be expressed in relation to quotas, and financing should only relate to the amount exceeding the threshold.

On the question of coverage, again I have few problems. The staff statement on the design of contingency mechanisms suggests that the staff will be following a very sensible and pragmatic approach. However, I would stress that we do not support the extension of contingency financing to cover shortfalls in lending by other creditors. This would not only give rise to inappropriate incentives, but could also, in practice, become tantamount to a growth contingency.

I was among those having doubts about the inclusion of interest rates in contingency financing. My doubts were, in part, based on the possible implications for the Fund's financial commitments. The staff has now proposed a number of limitations on the actual financing to be triggered by future interest rate changes, of which the requirement of parallel contingent financing by other creditors--combined with a requirement of confirmation of critical mass before activation of an external contingency mechanism--clearly is the crucial one. I would have few problems in supporting the inclusion of interest rates in the coverage of contingency financing on this basis.

At the same time, I recognize that questions can be--and certainly have already been--raised as to the feasibility of having such a direct link to contingent financing from other sources. Regardless of which formal text we might finally arrive at in this area, I would stress the overriding importance of not sending signals to banks indicating a fundamental change in the respective role of various creditors. Also, full coverage of financing gaps remains a crucial element of Fund programs. Therefore, particularly in the initial phase, the Fund should, wherever appropriate, try hard to insist on parallel contingent financing from banks.

I am skeptical as to the practicality of the suggested requirement that countries hedge part of their interest rate risk.

I can support the suggested methods for calculating deviations, as well as the proposals for phasing, monitoring, and application of symmetry in compensation.

On the specific question of activation, the staff has indicated that the use of contingency financing could normally be conducted in the context of a midterm program review. Nevertheless, the possibility of a less formal approach has also been mentioned, and I can agree to this. We should be careful in adopting procedures that could imply automatic contingency financing, especially during the introductory phase of contingency financing. Consequently, at this stage, I would be reluctant to accept approval on a lapse of time basis.

Finally, I would support the inclusion of a contingency element not only in arrangements under the enhanced structural adjustment facility, but also, following appropriate changes in monitoring procedures, those under the structural adjustment facility.

I will now turn briefly to the operational modalities for compensatory financing. As regards the 40 percent tranche for countries with an unsatisfactory track record, we would favor a 20/20 split.

When compensatory financing is made conditional upon approval of a Fund-supported program, such support should include upper credit tranche drawings, extended arrangements, and arrangements under the structural and enhanced structural adjustment facilities. We do not believe, however, that approval in principle of such programs should be sufficient to meet the requirement for drawing on the appropriate tranches of compensatory financing.

On the cereal decision, we prefer an adjustment of access limits in accordance with option (ii) on page 20 of the staff paper, but we can also accept option (iii). The Fund's policy on emergency assistance relating to natural disasters should be continued, separately from the regular Fund facilities.

We can accept the proposed divisibility of the optional tranche, provided that a choice is made at the outset and remains binding for the given program period. We can also support the staff's proposal regarding transitional arrangements, but are willing to consider other proposals.

Mr. Toé made the following statement:

I wish to take this opportunity to reiterate my authorities' disappointment with the outcome of the various discussions on the combined compensatory and contingency financing facility, which, in their view, is tantamount to a dismantling of the compensatory financing facility. The establishment of two separate facilities would have had the advantage of preserving the attractive features of the compensatory financing facility--namely, low conditionality, quick disbursements, high access--while providing insurance against unexpected adverse developments during the implementation of programs under upper credit tranche arrangements or arrangements under the structural and enhanced structural adjustment facilities. They are disappointed to see that these essential features of the compensatory financing facility are missing from the proposed new facility, particularly since, in our previous discussions and at the Interim Committee meeting, there was unanimity on preserving these essential features. However, now that a consensus has been reached by the Interim Committee on merging the compensatory and contingency elements into one facility, there is no need for me to further elaborate on the reasons underlying my authorities' position.

With the general principles and the basic framework for the new facility already agreed upon, I will focus my remarks on the issues that are still outstanding.

On the interpretation of the guidelines on cooperation in connection with the number and size of the tranches of the compensatory element, it appears that some ambiguities still remain, despite the efforts made to come to a straightforward application of the guidelines on cooperation. This is so for all cases except when the balance of payments difficulties are attributable solely to the effect of the export shortfall. Indeed, regardless of the country's track record it seems that there are always at least two tranches when the optional tranche is chosen. While the staff gives assurances that a country can draw up to 65 percent of its quota upon approval of an arrangement, it appears that a single drawing of up to 65 percent of quota would be granted only upon completion of a review of that arrangement. This seems to go against the spirit of the 1983 guidelines on cooperation.

A country with a good track record of cooperation should be granted an outright purchase of up to 65 percent of quota if it chooses to apply the optional tranche to compensatory financing. For countries with a less satisfactory track record of cooperation, lower tranche conditionality should be applied to 40 percent of the quota, and any drawing beyond 40 percent of quota could be subject to upper tranche conditionality. However, I would note that the process of tranching compensatory financing drawings runs against one of the basic features of the compensatory financing facility--the quick and timely character of the disbursement.

As to the application of the guidelines on cooperation in connection with approval of arrangements under the structural and enhanced structural adjustment facilities, there is no denying that a country entering into an arrangement with the

Fund under one of those facilities is committing itself to undertake policies deemed adequate to deal with its balance of payments problems. I can, therefore, endorse the interpretation that the term "arrangement with the Fund" in the 1983 guidelines on cooperation include arrangements under the structural and enhanced structural adjustment facilities.

On the link between compensatory financing facility requests and arrangements approved in principle, this chair has always held the view that an arrangement approved in principle meets the test of cooperation for compensatory financing facility drawings. The willingness of the authorities to cooperate with the Fund is demonstrated by their receiving a Fund mission and designing, with the mission's assistance, an adjustment program. The Board's approval of such a program, even in principle, testifies to the appropriateness of the policies contemplated under the program to deal with the country's balance of payments problems. It also enhances the chances for the successful implementation of the program. In this respect, it would be interesting if the staff could tell us how many arrangements approved in principle did not in fact become operative. As to the argument of the principle of adequate financing, I have no difficulty with compensatory financing purchases being an exception to this principle; therefore, such purchases should not be linked with the coming into effect of programs approved in principle.

On access under the cereal decision, our preference is for the establishment of a separate cereal facility, with the current access limit being maintained. However, if the combination of the two decisions is decided on, then I favor Alternative B in Annex I of the staff paper, which provides for a higher overall ceiling.

Turning to the operational modalities for external contingency mechanisms, I will make a few comments on the threshold, the mix of adjustment and financing, coverage, symmetry, and the arrangements eligible for external contingency mechanisms.

First, on the threshold and the mix of adjustment and financing, I concur with the staff that a threshold applicable across the board will not be of great help, given the diverse circumstances of member countries. In fact, as shown by the comprehensive reviews undertaken by the staff on Fund arrangements approved between 1982 and 1987, some programs can absorb large shocks while others cannot; this implies the need for a multiplicity of thresholds. Therefore, a great deal of judgment would have to be involved to determine, on a case-by-case basis, the appropriate threshold. I agree with the staff that, in making such a judgment, consideration should be given to the structure of the economy and the flexibility built into the program for the absorption of minor shocks. Here, unlike the staff, I would not rely too much on additional financing, because such financing might take too long to put in place. Neither would I rely on the scope for further policy action, which might prove to be very limited. In general, I favor a relatively low threshold, while keeping in mind the need to avoid frequent triggering of the mechanism for small deviations. As to the staff's proposal to finance only a proportion of the contingency deviation, we feel that the aim should be to compensate for the full amount of the deviation provided, of course, that the access limit allows it.

Second, on coverage, when it is possible to assess whether shortfalls in expected flows of foreign financing are beyond the authorities' control--in many instances, this should be feasible--the contingency mechanism should be activated to make up for the shortfalls. However, in view of the reasons given by the staff, I can understand that Fund resources should not be used to substitute for lending from other creditors. Perhaps parallel contingency financing could be considered in such situations. Given the increased emphasis on growth in Fund-supported programs, growth contingencies should be included in the coverage of the contingency mechanism, as called for by the Group of Twenty-Four. I can also agree with the suggestions to cover interest rates and exchange rate fluctuations.

Third, on symmetry with respect to favorable developments, my authorities are of the view that such "windfalls" should be used primarily to foster economic growth through increased imports of capital and intermediate goods. In certain cases, the unanticipated gains could be used to add to the member's reserves. We would not like to see symmetry of Fund financing applied to drawings other than those made under the external contingency mechanism. For purchases made under the basic arrangement, the Fund's existing policy on early repurchase should continue to apply in cases in which a substantial improvement in the external position occurred.

Fourth, it is my authorities' view that all Fund arrangements, including arrangements under the structural adjustment facility, should be eligible for contingency financing. Like other programs, those being implemented under that facility need to be protected against unexpected adverse developments.

My authorities have major difficulties with the staff proposal for converting quarterly benchmarks into performance criteria for the purpose of phasing external contingency mechanism disbursements on a quarterly basis. These disbursements should conform to the pattern of disbursements under the basic arrangement.

Finally, on the relationship between the compensatory financing facility and external contingency mechanisms, we can go along with the staff's suggestion that the optional tranche be completely divisible. But we are of the view that the choice of the allocation of the optional tranche should not be constrained by a time limit, as proposed by the staff. As to the transitional procedures, we share Mr. Kafka's views. We can also support Mr Dallara's suggestion to allow a temporary increase in total access under certain circumstances.

My authorities are of the view that the new facility's guidelines should be as simple to interpret as possible, in order to ensure uniformity of treatment, and that these guidelines should be implemented with flexibility in order to avoid delays.

Mr. Engert made the following statement:

My authorities feel that until some experience has been gained, the compensatory and contingency financing facility should operate on a cautious and modest basis. We also feel that the decision to establish the compensatory and contingency financing facility should probably not be too detailed. Initially, some experimentation will probably be needed to determine the best way of actually setting out individual contingency arrangements. During this period, the staff will need some flexibility and should be guided by the sense of the Board discussion, rather than by a very detailed decision, which might prove difficult to apply. With experience, the Board could reinforce any initial decision with more specific guidelines on how the facility should be implemented.

It follows that, given the complexity of the issues involved, there are a number of aspects which remain unclear. In this connection, it could be helpful if the staff could clarify and illustrate more fully its thinking in some areas, and provide some additional numerical examples or simulations. For instance, some additional background on the staff's statement on the design of contingency mechanisms might be helpful for all of our authorities to develop a better understanding of the issues involved, such as the calculation methodology, the distribution of contingent financing in multiyear arrangements, and dealing with double compensation, to name a few concerns.

My authorities are in general agreement with the main operational modalities for the contingency and compensatory components as suggested by the staff. However, in addition to this general endorsement, I would like to make a few comments on some of the specific issues raised. First, as regards the threshold and the mix of adjustment and financing involved with the contingency element, my authorities feel that the contingency element is not likely to be of much use in the case of very large shocks. We agree that small shocks can be best dealt with within the program, or by small alterations in some variables. Accordingly, my authorities feel that there is a need for appropriately high thresholds. In addition, we agree that thresholds will have to be established on a case-by-case basis, at least initially, and that the proportion of the deviation financed would generally be expected to decline as policy measures are implemented in response to external shocks.

As regards the nature of the Fund's commitment, my authorities agree that the features of individual external contingency mechanisms, such as the proportion of the contingency to be financed, access, threshold, and coverage, should all be specified in advance as clearly as possible. In addition, while we agree that it probably would not be feasible to formulate the details of a contingent policy response in many cases, we would expect some indication of potential policy action in response to shocks. However, we also feel that in virtually all cases it would be necessary to have a Board review before a contingency mechanism could be activated. Even in those rare cases in which all relevant aspects, including policy responses, can be specified in detail in advance, we think that at least lapse of time Board approval should be required.

Turning to coverage and calculation of contingent deviations, my authorities feel that a few variables should be chosen so as to maximize the coverage of the current account, subject to the constraints of having reasonably timely data and in accordance with the objective of covering only exogenous developments. We also agree that the contingency aspect should not cover shortfalls in capital flows, and that the baseline figures should be established on the basis of updated world economic outlook forecasts, to the extent possible. My authorities could go along with the coverage of interest rates as presented by the staff. In principle, we feel that an external contingency mechanism covering interest rates should not be agreed to unless bank creditors also provide parallel contingent financing.

My authorities agree with the suggestion that purchases under the external contingency mechanism would normally be phased with purchases under the associated arrangement, and that members would have to satisfy the conditions for drawing under that arrangement to qualify for an external contingency mechanism drawing.

We regard symmetry as an important feature of the proposed facility, and my authorities agree that members should be prepared to reduce use of Fund resources when developments turn out better than expected. In this connection, the staff paper mentions reducing potential use of Fund resources under the basic arrangement, but it is not clear which drawings would be affected. My authorities also like the idea that a member could have the option to repurchase earlier external contingency mechanism purchases to restore its contingency access.

With respect to the compensatory element, my authorities are in general agreement with the proposals presented by the staff. In particular, we endorse two tranches of equal size for poorer performers. As regards the link with other arrangements, for upper tranche compensatory financing drawings, arrangements under the structural and enhanced structural adjustment facilities should be assessed to qualify on a case-by-case basis. For cases in which an arrangement has been approved in principle, my authorities would prefer that in most cases, the upper tranche of the compensatory element also be approved only in principle. We would prefer that any potential outright purchase in such cases be limited to the lower tranche of the compensatory component.

Regarding the cereal decision, my authorities do not see any need to increase the overall ceiling of 105 percent, and we feel that the joint limit for export shortfalls and cereal excesses should be 65 percent, including the optional tranche. In other words, we feel that Alternative C of Annex I is appropriate.

In cases in which a member has a satisfactory balance of payments position except for the effect of an export shortfall and/or cereal excess, access to compensatory financing should be up to 83 percent of quota.

Finally, we can go along with the staff's general proposals concerning the optional tranche, transitional arrangements, and double compensation.

Mr. Goos made the following statement:

We are in broad agreement with the thrust of the staff proposals before us. Many of the operational aspects of the new facility will need to be determined in the light of the particular circumstances of individual requests. However, we feel that the operational guidelines should be specified in advance as precisely as possible in order to secure uniform treatment of members. To the extent that this is not possible, the scope for ad hoc specification should remain under the Board's control. We therefore attach great importance to the staff's proposal that the Board would be involved both at the stage of approval and activation of external contingency mechanism arrangements.

Moreover, I agree that we should review the operation of the combined facility in the not too distant future, perhaps in one and a half years' time.

I will now take up the issues under consideration in the order they are presented in the summary chapter of the staff paper, addressing only those aspects on which we differ with the staff or to which we attach particular importance.

As regards access to contingency financing, I wish merely to emphasize that contingent financing should be limited to cases in which the design of the underlying arrangement is not fundamentally affected by the external shocks, so that it remains basically appropriate to cope with the new situation. Otherwise, as proposed by the staff, the adjustment framework would need to be reconsidered and possibly reformulated on the basis of a new arrangement. The possible need to do so, I believe, is related not exclusively to the magnitude of the additional financing required to meet the contingency, but also to the nature of the shock that could render an arrangement obsolete. I could envisage a situation in which, even within the 70 percent financing limit, certain shocks could cause the total derailment of the program, thereby necessitating a reformulation of the program. However, this will have to be considered on a case-by-case basis.

As to the apportionment of access under multiyear arrangements, I could go along with the flexible approach proposed by the staff, provided that that flexibility, including the envisaged front-loading, would be used cautiously. Otherwise, one might run out of the necessary financing to cover shocks that occurred later in the program period.

I am afraid I cannot accept Mr. Ortiz's proposal to provide for contingency access for enhanced surveillance, particularly given the statement by the Interim Committee that use of the contingency element would be attached to a Fund-supported adjustment program.

On the threshold and the mix of adjustment and financing, I broadly agree with the approach outlined by the staff, particularly with the view--at least, as I understand it--that the Fund should only finance contingencies above a certain threshold level. Disturbances below that threshold should be absorbed by the underlying arrangement through integrated margins against relatively small external shocks. So, unlike Mr. Dallara and others, I feel that the amount of the threshold should indeed be deducted from the total deviation. Participation by the member in the financing of deviations would be essential to us because full financing could create an incentive for the formulation of unduly optimistic and ambitious program assumptions. If a country is assured that program deviations will be financed without any deductions, it would have an incentive to keep its program margins as low as possible. Moreover, since deviations up to the threshold are supposed to be covered by program margins, nondeductibility of the threshold would amount to double compensation for that portion of the deviation. For these reasons I feel that it would be desirable to establish a standard minimum threshold level for contingency financing, say, at 10 percent of quota. Above that minimum level, individual thresholds could then be set, taking into account the specific circumstances of members as proposed by the staff.

On the nature of the Fund's commitment and the activation of financing, I can endorse the views expressed by Mr. Dallara, although as regards the activation procedure and the Board's involvement, my preference would clearly be for the position expressed by Mrs. Ploix. As you know, we had--and basically continue to have--considerable difficulties with the notion of automaticity. However, we are, of course, prepared to support the compromise endorsed by the Interim Committee in "some exceptional cases" as a sort of experiment and subject to a possible reconsideration of our position in light of the forthcoming review of the facility. At any rate, we consider it essential that drawings would require observance of the relevant performance criteria and would be phased. If the majority of the Board adopts the activation procedure for exceptional cases, as proposed by the staff, I would recall the Chairman's proposal at one of our earlier discussions of the subject, that disbursements should then be made only after sufficient advance notification to the Board, supplemented by the information necessary to allow a considered assessment of each transaction.

On the coverage of contingent variables, we continue to feel that it would have been preferable for the Fund not to engage in the financing of interest costs, for the reasons I have repeatedly presented to the Board. It therefore might not come as a surprise that my authorities attach great importance to the introduction of additional limitations and safeguards such as the ones discussed in the paper. Accordingly, I could endorse the coverage of interest payments only if interest cost financing were accompanied by contingent support from other creditors, notably commercial banks, as proposed by the staff; and if, as proposed earlier by Mr. Dallara, overall access for interest cost financing were limited to 35 percent of quota.

Within these constraints, I could go along with the coverage of nominal interest rates, which should be limited to unforeseen changes in benchmark international interest rates, such as LIBOR. Moreover, while endorsing the notion of compensating net interest payments, we feel that gross interest payments and receipts should be calculated on a comparable basis. That is, if receipts on officially owned foreign assets were to be taken into account, as proposed by the staff, then interest payments should also be calculated on the basis of official external debt only. Alternatively, in the framework of a broader concept, it should be possible to include at least the aggregate private assets as shown in the international banking statistics.

As to the question of whether the contingent criteria to be covered should be determined on an ad hoc basis or in the predetermined, more comprehensive manner proposed by Mr. Dallara, I have considerable sympathy for the latter approach, although I am not certain about its feasibility in view of the statistical problems mentioned by the staff. For the time being, I have to reserve my position on this issue until the Board decides on the safeguards for the coverage of interest rates that I just proposed.

As to the calculation of contingent deviations, the staff's analysis reveals a number of difficult issues related to the availability of data and the assessment of the exogenous nature of the shocks, which warrant further study by the staff. In general, I consider it essential that deviations be calculated on the basis of objective criteria so as to avoid moral hazard problems in the context of program design. Moreover, in calculating the size of contingent deviations, all offsetting developments in the current account should be taken into account. Such an approach would appear to be particularly advisable if the contingent criteria to be covered were determined on an ad hoc basis.

On phasing, Mrs. Ploix has asked a number of pertinent questions, which I think deserve further consideration. For the time being, I am inclined to endorse Mr. Dallara's views on the treatment of "late shocks." The question of possible ad hoc augmentation of access under multiyear arrangements should be considered at a later stage, in the light of the evolving experience with contingency financing.

Symmetry should be an essential feature of contingency financing, and we therefore feel that the necessary procedures need to be specified before the new facility becomes operational. As regards symmetry of Fund financing there should be an obligation--and not just an expectation--for members to reduce the use of Fund resources under the associated arrangements should developments turn out to be better than expected. In cases of favorable deviations after external contingency mechanism purchases had been made, I would favor early external contingency mechanism repurchases--instead of reducing the amount of financing under the basic arrangements.

Regarding the arrangements eligible for external contingency mechanisms, I was rather content with the approach proposed by the staff, although I must say that I have sympathy for the inclusion of arrangements under the structural adjustment facility. But I would like to reserve my position on this issue. In general, I would opt for quarterly performance criteria, which would necessitate corresponding adjustments of extended arrangements and those under the enhanced structural adjustment facility that provide for intermediate benchmarks.

I can endorse the views expressed by Mr. Dallara with regard to the matters of overcompensation and undercompensation, approval in principle, and access under the cereal decision. On the issue of approval in principle, I might add that this instrument has been introduced to protect the Fund's resources. If the Board, in a specific case, comes to the conclusion that there is a need for such protection, there is little justification for not extending such protection to the resources disbursed under the compensatory financing element.

I can support the proposals, including the transitional procedures for compensatory financing requests, as set out in the staff's statements at the beginning of the meeting. However, on this latter aspect, in view of the difficulties that some of my colleagues have, I am prepared to listen to comments by the staff, and to perhaps reconsider my opinion.

While the projected impact of the compensatory financing facility on the Fund's liquidity on a disbursement basis appears quite manageable from today's perspective, the calculations of potential commitments indicate that the future use of Fund resources could reach quite substantial proportions. Considering the highly tentative nature of these calculations, they provide a clear signal for caution, including limiting overall excess of the facility to 105 percent of quota and introducing additional limitations to the financing of interest costs.

Mr. Posthumus made the following statement:

The document on modalities for the compensatory and contingency financing facility makes clear that much work still has to be done, and much experience still has to be gained in order to make it an effective facility that is also in conformity with the monetary character of this institution. I think that it is necessary that a review be held, and a first draft of guidelines be discussed by the Board within a year, and no later.

Taking the summary of EBS/88/100 as a guideline, I will give comments on the issues to be solved, mentioning only those subjects on which I differ from the staff proposals.

As regards the threshold, the staff proposes a case-by-case approach. I suggest a more uniform approach on which I would like the staff to comment. I wonder whether the threshold could be a percentage of the underlying arrangement. The rationale would be that the size of the program itself gives an indication of the size of the adjustment process, and therefore also of the extent to which shocks can be absorbed by the underlying program itself. As an alternative I would suggest 10 percent of quota.

The proportion of the deviation to be financed beyond the threshold is indeed difficult to decide, and it may well be, for example, that the financing proportion can be higher in a stand-by program with a duration of one year than in a three-year program under the enhanced structural adjustment facility. Because of the maximum access of 70 percent of the underlying arrangement, a percentage which I think is rather high, it might be necessary to set a maximum proportion of financing so as to guarantee that adjustment will indeed be undertaken. Before taking a final position on this, I should like to get more of an indication of the staff's thinking in this respect.

In any case, I think it would be necessary for the baseline scenario to be adjusted once a country has used the contingency element of the facility, because the adjustment efforts carried out as a necessary condition for the use of the contingency facility change the economic outlook. This approach would help to prevent a second drawing on the facility for essentially the same kind of contingencies. With 12- or 18-month baseline projections at each review, late shocks could be accommodated if the country decides to lengthen the original arrangement.

As regards activation of the contingency as proposed by the staff, my only reservation is the lapse of time procedure in certain cases. I think that in the first year of the new facility this procedure should not be followed.

As regards the interest rate element in the contingency facility, I continue to feel that the Fund is taking a wrong decision by financing--even only temporarily--increased interest payments to commercial banks and other financing institutions. This institution should have resisted such proposals. I will not repeat the arguments for this position given in my statements at Executive Board Meetings 88/37 (3/4/88) and 88/50 (3/28/88). The proposal that interest rates be covered only when parallel contingent support by the banks is arranged, has my sympathy. It is an approach comparable to the "new money" requirement in the framework of the debt strategy. Whether it should not be a condition, as Mr. Dallara suggests, is an issue that I would like to decide upon after having heard the staff response to questions by several Directors on whether such a condition would not make the interest contingency impossible. At least a

35 percent of quota upper limit should be set for the interest contingency. Furthermore, the debtor country itself should undertake hedging operations and only countries that have made sufficient arrangements should be eligible for interest contingency financing.

I think that the paper on the management of financial risk in developing countries should have been sent to the Board before, and not after, the interest element in the contingency facility is institutionalized. It would in fact be better to postpone the interest contingency element until this paper has been discussed by the Board, or until more information is made available on possibilities of hedging and comparable operations.

As regards the compensatory financing requests that accompany arrangements approved in principle should be approved in principle also, if there is reason to assume that outright compensatory financing approval would not be in agreement with the financing assurances which always have to be sought in Fund financing. I, therefore, think that compensatory financing drawings can sometimes be possible even if there is only an approval in principle of the stand-by arrangement. I wonder, though, how we would treat situations in which compensatory drawings under the compensatory and contingency financing facility were allowed, and the stand-by arrangement was approved in principle only, after which another external contingency made the country eligible for another drawing. This problem will have to be solved.

Regarding access under the new compensatory and contingency financing facility, there should be no exceptions to the 105 percent of quota limit we have agreed upon, neither as a transitional arrangement for compensatory financing purposes, nor in the context of the cereal facility.

Finally, there are three points that the Chairman suggested be addressed. On the optional tranche, I support the staff proposals. On the transitional period, I share Mr. Kafka's doubts, and I wonder whether we could leave the choice between the existing compensatory financing facility and the new compensatory and contingency financing facility to member countries during a specific and short period of two or three months after we have decided on the compensatory and contingency financing facility.

On Mr. Ortiz's proposal to make it possible to link the compensatory and contingency financing facility to enhanced surveillance, I have a somewhat uncertain feeling. I wonder why the country concerned in this situation could not ask for a stand-by arrangement which is intended to provide the same kind of support, in a broader framework and with fewer limitations.

Also, as Fund resources can only be made available if there is a balance of payments need, there would indeed probably be a wider need than for external contingency mechanisms only. The proposal gives me a somewhat uncomfortable feeling that the good instrument, the stand-by arrangement, might be driven out instead of being improved upon, which I think is the idea behind the compensatory and contingency financing facility.

Mr. Nimatallah made the following statement:

If I do not address a particular point, that means I agree with the staff on that issue.

On transitional arrangements, I can see three questions involved: one has to do with time, another has to do with countries involved in discussions with the staff, and the third has to do with access. On establishing a deadline, I have no difficulty with the staff's proposal, in its statement on transitional arrangements. On the number of countries involved at present in discussions with the staff, I can go along with Mr. Kafka's suggestion to make known the names or the number of the relevant countries. And, on access, I can accept Mr. Dallara's suggestion, namely, to allow for initial access of up to 40 percent of quota, regardless of the amount of compensatory financing credit outstanding at the time of initiation of contingency financing.

I am pleased to read in the staff's statement on the design of contingency mechanisms that the staff has carried out simulations of 19 actual or potential arrangements to test possible designs of contingency mechanisms. I am satisfied that the information gathered from these simulations can give insight on how to design external contingency mechanisms with more confidence, on a case-by-case basis. However, the Fund should maintain flexibility as it accumulates more experience with external contingency mechanisms over time.

On the modalities of contingency financing, I am in general agreement with the staff's understanding and proposals. I am now even more convinced that external contingency mechanisms should be designed and implemented on a case-by-case basis. Each case will have its own characteristics and therefore should be treated accordingly. I have no problem with the four basic considerations on the nature of the Fund's commitment in providing contingent financing, namely, the size of the threshold, the mix of financing and adjustment, the annual distribution, and the phasing of purchases. I agree with Mr. Dallara's suggestion to express the threshold in terms of quotas, and not GDP.

However, I wonder whether a range of 10-25 percent of quota, instead of an absolute figure of 10 percent, might not introduce more flexibility.

On coverage, I am still not sure how interest rate coverage would be handled; my doubts are reduced, but not eliminated by the limitations introduced, including the view that the Fund should not disburse its contingent financing until parallel financing is arranged. Let me make clear that I am talking about disbursement and not commitment. However, this requirement should be applicable primarily in cases that require large amounts of financing that could not be covered sufficiently by what the Fund is willing to offer through the external contingency mechanism. If the deviation equals, say, 35 percent of quota, and the needed contingent financing for an unfavorable deviation in interest rates is about, say, 200 percent of quota, then there is a clear need for parallel financing since the Fund's support alone would obviously not be effective in reducing the negative impact of the deviation.

On symmetry, I suggest that favorable deviations taking place very early on in the program period be devoted solely to building up reserves, which can be used later as one of the sources--together with the Fund's resources--for the financing of potential, unfavorable deviations.

I have an open mind on whether reviews should be extensive or speedy, but Board approval is legally necessary as external contingency mechanisms are only approved in principle by the Board when they are attached to a program, and disbursement has to receive outright approval. However, this Board approval can be in any form, including on a lapse of time basis.

I do not think it is necessary to change the name of the compensatory financing facility at this stage, at least not until we gather more experience from the operation of the combined facility. As far as I can see, there will be as many different external contingency mechanisms as there are members to benefit from them. In the meantime, the 83 percent of quota access for the compensatory financing facility still exists for members that suffer from shortfalls without experiencing fundamental payments imbalances.

I am in favor of considering the idea that contingency financing be extended to a member under enhanced surveillance by the Fund, if a well-qualified shadow program is faced with unfavorable developments that could threaten its progress. However, I am not sure about this idea's practicability, and I would like the staff to look into it carefully before I give my final views.

The division of the 40 percent lower tranche of the compensatory financing facility into 20/20 for members with a less cooperative track record should be the exception, and not the rule. On the question of approval in principle of drawings under the compensatory financing facility, I agree that members with a good record of cooperation should have the full 40 percent access under the compensatory financing facility made available outright, without a Fund-supported program; even for members with an unsatisfactory record of cooperation, 20 percent of quota should be made available on the basis of prior actions. As for the second 20 percent, for those with an unsatisfactory record of cooperation, this portion should be approved in principle only. For the 25 percent optional tranche, I think that approval of a Fund-supported program in principle for those members with a good record of cooperation would be sufficient for an outright disbursement.

On the cereal decision, I have an open mind, and I can support either Alternative A or C, as explained by the staff in the Annex.

I support divisibility of the optional tranche according to the member's wish, and I have an open mind on whether this wish be expressed early or late.

Mr. Finaish made the following statement:

Before addressing some of the specific issues raised in the staff paper, let me say that the paper before us serves as a good reminder of the complexity of this new facility and the large number of questions that the staff and the Board will have to deal with in applying the general policy guidelines to individual cases. These questions are likely to be difficult, both technically and because of the great deal of judgment that will be needed. Although the broad outlines of the new facility have already been agreed upon, and even if the issues raised in the staff paper are settled soon, the real test lies in implementation. We therefore share the view that many aspects of the new facility should be applied on an experimental basis. A review within, say, one year of the operation of the facility will be particularly important, not only to assess the need for specific changes in guidelines and implementation, but also to evaluate more broadly the joint framework for contingency and compensatory financing. This joint framework was the result of a difficult compromise, but its adequacy should be evaluated with an open mind in the future in the light of experience.

Let me now turn to some of the specific issues on which Board guidance is being sought. First, with respect to external contingencies, the staff's suggestion that access to the contingency window would be separate from the access limits specified under the policy on enlarged access, seems to be reasonable. We can also support the exclusion of contingency purchases from the calculation of reserve tranche positions.

In most cases, front-loading of access may well be justified in multiyear arrangements. A carry-over of unutilized access to the latter years of an arrangement should be allowed in all cases.

As to the desirability of a uniform threshold, we can see both sides of the argument and therefore have an open mind on this issue. If a uniform threshold is preferred, it should be set at a rather low level in order not to penalize any group of countries. In our view, the calculated deviation from the baseline should be inclusive of the threshold. As to the possibility of prespecifying the proportion of the contingency to be financed by the Fund, we have doubts whether that would be necessary, given the fact that access is limited by two ceilings already. Also, cases and circumstances may differ a great deal, making prespecification impractical.

Coverage should be determined on a case-by-case basis. Current account receipts from remittances and tourism should, of course, be covered in cases in which such receipts constitute a significant component of the balance of payments. We can also see merit in capping contingent access associated with interest costs, in light of the concerns expressed by many Directors on this matter. In this connection, it would be useful if the staff could comment on the fact that, in the case of some variables, the world economic outlook does not include projections as such, but rather, working assumptions. Does the staff expect a change in this practice for the purposes of the external contingency mechanism?

With respect to activation, the objective should be to avoid delays to the extent possible. Where possible, automatic triggering should not be ruled out. In all cases, however, Board approval of disbursements should be sought in an expeditious manner.

When a contingency occurs late in an annual arrangement, we agree that access under a subsequent arrangement should take that into account. In multiyear arrangements, the staff mentions three possible courses of action. We have an open mind on this issue but the emphasis should primarily be on utilizing contingency financing when possible.

On the question of symmetry, the staff mentions a number of options in the case of favorable developments and also in the case of contingent Fund financing associated with an unfavorable development that is quickly reversed. An important consideration should be the manner in which the member responds to the favorable development. If, for example, the member uses the gains from that development to attain external viability faster than envisaged under the initial assumptions of the program, a reduction in access may not be necessary. It is true that lowering the amounts committed under the arrangement would increase the availability of Fund resources in the event of future need, but it may well be that the maintenance of the original access level will enable the country to undertake stronger policies and thus obviate that future need. In any event, a flexible approach to the application of symmetry would be useful.

In our view, it should be possible to incorporate contingency procedures into arrangements under the structural and enhanced structural adjustment facilities, as well as into stand-by and extended arrangements. Ad hoc reviews of arrangements under the structural adjustment facility could be used to activate contingency drawings.

We can agree with the proposal for using ordinary resources to finance contingency drawings, and can also support the suggested repurchase period.

We agree that contingent support from other sources in parallel with Fund financing is important and should be sought. The staff raises a question in the second full paragraph on page 16 of EBS/88/100, on whether in cases where contingent financing from commercial banks is involved, a critical mass of such financing would be necessary before the associated arrangement could be approved. This does not seem to be justified. The approval of the arrangement itself should not be conditional on the contingency element. Neither should Fund contingencies always be conditional on the availability of contingency financing from other sources.

Turning to compensatory issues, an important element of the compromise that was reached last April is the distinction between countries with a good record of cooperation with the Fund and those with an unsatisfactory record. One problem that the staff and the Board will have to face is the fact that the record of many countries lies somewhere in the middle. This may prove to be a contentious aspect of the new procedures. It would be useful if the staff could comment on this issue and on how it intends to deal with those mixed cases given the either/or nature of the judgment that has to be made.

Regarding the tranching of the compensatory component, we see merit in Mrs. Ploix's suggestion of setting the lower tranche at 25 percent of quota, on the assumption that this matter is yet to be decided.

Where an arrangement is required, we believe compensatory financing should be provided on the basis of an arrangement under the structural or enhanced structural adjustment facility in addition to stand-by and extended arrangements. In the case of the optional tranche, an ad hoc review of an arrangement under the structural adjustment facility should be the basis for disbursement.

Approval in principle of an arrangement should be sufficient for the disbursement of compensatory financing when such an arrangement is required. At a minimum, this should apply to the first tranche of the compensatory component. In the case of members with a satisfactory record, this would mean 40 percent of quota.

With respect to the cereal decision, our preference is for option (iii) as outlined by the staff. As to cases in which the balance of payments position is satisfactory except for the effect of the shortfall, we can support option (i) as described in footnote 2 on page 21. This would be consistent with the spirit of the compromise that preserves the old guidelines, including the access limit of 83 percent of quota, in cases in which the balance of payments difficulty is attributed only to the shortfall.

We can go along with the staff's proposals regarding the projection limit and overcompensation, provided that symmetrical adjustments are made in the case of undercompensation.

Turning to the relation between compensatory and contingency components, we believe that the optional tranche should be completely divisible, with the member free to choose the manner in which that tranche is to be utilized. Moreover, we do not think it is necessary for members to make that choice in advance. The staff's argument in this connection seems to imply that somehow the preservation of contingency access is more important than being compensated for an export shortfall, even when such compensation is needed.

As to the transitional arrangements, we are not convinced by the staff's argument in favor of setting the deadline as of today's discussion. In our view, until the new facility is in place, compensatory financing facility discussions between the Fund and members should be based on the current procedures. A three-month grace period, beginning when the new facility is established, seems to be reasonable. Regarding access of members with outstanding compensatory financing facility purchases, we can support Mr. Dallara's proposal.

Finally, Mr. Abdallah has raised the question of contingencies caused by natural disasters. While we can agree to keep natural disasters outside the scope of the new facility, partly because external contingency mechanisms are associated exclusively with Fund arrangements, we agree with Mr. Abdallah that natural emergencies can have the same effects on exports as other exogenous developments. This suggests that the policy on natural disasters should perhaps be re-examined with a view to revitalizing it so that it can complement the contingency mechanism under the new facility.

Mr. Dai made the following statement:

Before addressing the specific issues put forward in the staff paper, I would like to stress a few principles which I see as important in considering the subject we are discussing today.

The operational modalities of the new facility should embody the agreed principle that, while adjustment programs can be well protected against unforeseen exogenous shocks, the essential features of the compensatory financing facility should be preserved. The rules and procedures governing the compensatory and contingency financing facility should be as simple and transparent as possible. Since the new facility will have to be implemented on an experimental basis, a considerable amount of flexibility will be needed.

I shall now turn to specific issues and will simplify matters by grouping topics into three categories--namely, those topics on which I generally agree, those with which I have problems, and those to which I should like to respond.

First, I can agree in principle with the staff's proposals that access limits for the new facility would be outside the access limits specified under the policy on enlarged access, and that external contingency mechanism purchases would float above the reserve tranche, with the calculation of the contingent deviations being made as proposed by the staff. On activation of the external contingency mechanism, "lapse of time" approval would be acceptable to this chair in certain cases; and I do not believe that that would jeopardize the authority of the Board, since any Director is entitled to challenge the move if he wishes. I can also agree on the staff proposals on symmetry provisions. As to the question of how the unanticipated gains should be conserved, there are a number of options proposed in the staff paper, but it would be better to leave the determination of priority in the hands of the member country.

On arrangements eligible for external contingency mechanisms, arrangements under the structural adjustment facility should not be excluded; the monitoring procedures for those arrangements do not appear to be a difficult problem. Use of the new facility should be financed with the Fund's ordinary resources, with a repurchase period of three to five years.

I agree that the optional tranche of the facility should be completely divisible, but the proposed restriction on timing of choice is unnecessary. I can also agree to the procedures for avoiding possible double compensation.

Second, I have questions, or a different opinion, on the following issues. The proposed means of distributing contingency financing in multiyear arrangements appears rigid and may not adequately meet the requirement of the contingency. However, I agree with the idea of permitting front-loading of external contingency mechanism access and carry-over of unutilized access to the following year.

I have a question on how the size of the threshold could be better determined. If an appropriate common criterion cannot be set, a general rule or guideline should be found. Regarding coverage, while I have sympathy with the staff with respect to the difficulties and concerns involved in covering capital movements in contingency mechanisms, I am still not fully convinced that a shortfall of capital inflows should be exclusively ignored. Special cases might need to be considered. For instance, major worldwide shocks beyond the control of the member countries could occur in the international financial markets, resulting in a credit crunch or panic that could threaten not only the adjustment programs of some debtor developing countries, but also international economic trade and payment relations in their entirety, owing to chain reaction repercussions. If the Fund, as one of the most important international financial cooperative institutions, whose responsibilities are to safeguard international financial stability and promote world economic development and prosperity, withholds its support at this critical juncture to those countries that are hardest hit and seeking contingent relief, then who else will be able to step forward and replace the Fund in its important role? In these circumstances, I believe there is no insurmountable difficulty in assessing whether or not such a shortfall of capital movements is beyond the member country's control.

Regarding the requirement of the adequacy of financing, while I agree that the Fund should strengthen its catalytic role in contingency financing, I am very skeptical about the Fund withdrawing its support if other creditors do not follow suit and a critical mass of parallel financing is not secured. The question here is who should play the leading role--the Fund or the commercial banks?

With respect to the modified compensatory financing facility under the new facility, it appears that conditionality has become harsher than before, especially that for members with less satisfactory records. As access is reduced, conditionality is tightened; for example, prior action would be required even for access to the first tranche of 20 percent of quota. In this context, I agree with Mrs. Ploix and other Directors that the size of the first tranche should be raised. Besides, it is not clear to me how a member without any arrangement can request the upper or optional tranche under the compensatory financing facility.

The proposed transitional provisions seem neither necessary nor appropriate. I agree with the views of Mr. Kafka and Mr. Dallara on this issue.

Third, with regard to the questions raised in the staff paper, I agree that an arrangement approved in principle would meet the test of cooperation for a compensatory financing purchase, and with regard to the cereal decision, my preference is the third option (iii) appearing on page 21 of the paper.

Mr. Rye made the following statement:

I shall be concentrating on areas in which I differ with the staff paper and, for the rest, shall abide by the principle that "silence implies consent."

This is a complex paper dealing with a large number of issues. Many of the complexities arise from the fact that the proposal is trying to merge into one facility two elements, which, despite some superficial similarities, have quite different rationales, and are designed to meet the problems of member countries in quite different circumstances.

I very much agree that we need to keep the facility as simple as possible, despite the inherent complexities. It does follow that we probably have to accept a case-by-case, experimental approach to the modalities of the combined facility. I am concerned that such a process should not unduly reduce the role of the Board in the development of policy, and I welcome the suggestions that have been made to engage the Board fully in the policy development process--such as an early review of the facility; I would favor a review within one year. I also endorse

Mr. Dallara's expectation that the staff will bring to the Board's attention any specific implementation problems which arise. I was a little disappointed that the staff paper did not try to establish some quantitative guidelines, in particular with regard to the threshold level.

Turning to some particular points, I have just one reservation on access; I am not attracted to the suggestion, mentioned in the final paragraph of Section 2a on page 3 of EBS/88/100, that provision might be made for front-loading of contingency access in a multiyear Fund-supported program, or allowing for carry-over of unitized access to later years. Too much flexibility in this regard could lead to contingency resources being used to overcome shortcomings in the design of the original program, or to defer renegotiation of a new program where this would be more appropriate.

On the threshold question, I am in favor, in principle, of common thresholds, in the interest of equality of treatment. I expect that the staff will be examining and reporting back on the proposals made by Mr. Dallara and Mrs. Ploix for quantitative thresholds, and I would like to see Mr. Posthumus's idea of relating threshold to the size of the associated program also considered in this context.

I have no problems with the staff's discussion of the Fund's commitment, coverage, and calculation of contingent deviations though I would underline the need for the proposal at the top of page 7 that "by the time a request for an arrangement which incorporates an external contingency mechanism is submitted to the Board, it should be accompanied by an indication of the nature of the appropriate policy responses that would be forthcoming in the event of adverse shocks."

Moving on to activation, phasing and monitoring, the two complete paragraphs on page 11 pose some puzzles. I do not understand the distinction between the two cases presented here, if indeed there is a distinction. In the first paragraph, there is reference to a "staff assessment" and the Board being "informed," while in the second, reference is made to "review" and Board approval--albeit on a lapse of time basis. If these are alternative formulations of the same thing, I would prefer the latter, but I accept Mr. Ortiz's comment that the first version is more in accord with the letter of our earlier consensus.

I fail to understand why ad hoc augmentation of contingency financing, referred to at the foot of page 12, would be necessary for multiyear arrangements, even on an exceptional basis. Some basis. Some elaboration by the staff on this would be helpful. I see no need for any special provisions in cases in which external shocks occur late in a program.

On the compensatory financing facility and its relationship with the external contingency mechanism, the optional tranche should be made available to a member whose record of cooperation with the Fund is unsatisfactory only if an arrangement is in place and a review suggests satisfactory progress.

In my opinion, the cereal decision should be rescinded as redundant and out of keeping with the nature of the Fund. But assuming that it is to be retained, with regard to the joint use of the compensatory financing facility and cereal facility, I consider option (ii) the preferable situation and more consistent with the thrust of the merging of the compensatory financing facility and external contingency mechanism provisions.

On divisibility of the optional tranche, I had the same impression as Mr. Dallara--that the choice would be one way or the other. But I note that many members seem to attach much significance to full divisibility, and I have no objection to it.

I agree with Mr. Kafka that the staff statement on transitional arrangements for existing compensatory financing facility negotiations is vague. It would be more clear cut if these transitional provisions applied only to those members who lodged a formal request for compensatory financing prior to Board approval of the decision on the compensatory and contingency financing facility. However, I accept that there is some case for a transitional period, not, I suggest, to exceed three months.

Finally, I think that Mr. Ortiz has raised a most interesting suggestion regarding the availability of contingency financing under enhanced surveillance arrangements. It seems to have a good deal of attraction in principle, though I am not sure about some of the practicalities. I agree that the staff should give this proposal careful consideration.

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/88/93 (6/15/88) and EBM/88/94 (6/17/88).

2. ZAMBIA - 1988 ARTICLE IV CONSULTATION - POSTPONEMENT

Notwithstanding the period of three months specified in Procedure II of the document entitled "Surveillance over Exchange Rate Policies" attached to Decision No. 5392-(77/63), adopted April 29, 1977, as amended, the Executive Board agrees to extend the period for completing the 1988 Article IV consultation with Zambia to not later than July 8, 1988. (EBD/88/164, 6/14/88)

Decision No. 8906-(88/94), adopted
June 16, 1988

3. CHILE - TECHNICAL ASSISTANCE

In response to a request from the Chilean authorities for technical assistance in the fiscal field, the Executive Board approves the proposal set forth in EBD/88/160 (6/13/88).

Adopted June 16, 1988

4. EXECUTIVE BOARD TRAVEL

Travel by Executive Directors as set forth in EBAP/88/145 (6/14/88) and EBAP/88/147 (6/15/88) and by Advisors to an Executive Director as set forth in EBAP/88/147 (6/15/88) is approved.

APPROVED: January 25, 1989

JOSEPH W. LANG, JR.
Acting Secretary