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0404

INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 88/101

3:00 p.m., June 27, 1988

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

Executive Directors	Alternate Executive Directors
	S. M. Hassan, Temporary
F. Cassell	
Dai. Q.	
C. H. Dallara	
J. de Groote	J. Prader
A. Donoso	E. V. Feldman
	S. K. Fayyad, Temporary
	B. Goos
J. E. Ismael	J. Reddy
A. Kafka	
	W. N. Engert, Temporary
	N. Toé, Temporary
Y. A. Nimatallah	I. A. Al-Assaf
	L. Filardo
	M. Fogelholm
	D. Marcel
G. A. Posthumus	G. P. J. Hogeweg
	C.-Y. Lim
	S. Rouai, Temporary
A. K. Sengupta	L. E. N. Fernando
	N. Adachi, Temporary
	N. Kyriazidis

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

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Also Present

African Department: A. T. B. Taylor. Asian Department: R. J. Hides. Exchange and Trade Relations Department: L. A. Whittome, Counsellor and Director; P. A. Acquah, S. B. Brown, D. Burton, A. Leipold, C. Puckahtikom, B. C. Stuart. External Relations Department: D. M. Cheney. Legal Department: F. P. Gianviti, General Counsel; T. M. C. Asser, P. L. Francotte. Middle Eastern Department: H. P. G. Handy. Research Department: J. A. Frenkel, Economic Counsellor and Director; A. D. Crockett, Deputy Director; L. Alexander, R. G. Alter, E. Hernández-Catá, N. M. Kaibni, H. C. Kim, E. C. Meldau-Womack, P. R. Menon, B. E. Rourke. Treasurer's Department: I. S. Kim, O. Roncesvalles. Western Hemisphere Department: S. T. Beza, Director; M. Caiola, Deputy Director. Personal Assistant to the Managing Director: H. G. O. Simpson. Advisors to Executive Directors: A. A. Agah, A. G. A. Faria, K.-H. Kleine, A. Vasudevan, J. E. Zeas. Assistants to Executive Directors: R. Comotto, B. R. Fuleihan, S. Guribye, L. Hubloue, A. Iljas, C. Y. Legg, V. K. Malhotra, L. M. Piantini, S. Rebecchini.

1. COMPENSATORY AND CONTINGENCY FINANCING FACILITY - MODALITIES

The Executive Directors resumed from the previous meeting (EBM/88/100, 6/27/88) their consideration of a staff paper on modalities for the compensatory and contingency financing facility (EBS/88/100, 5/24/88; and Cor. 1, 5/25/88), together with the statement made at EBM/88/100 by the staff representative from the Exchange and Trade Relations Department.

Mr. Kafka suggested that proceedings continue as quickly as possible so that discussion of the compensatory and contingency financing facility could be concluded at the current meeting. Unfortunately, he would not be able to attend the Managing Director's lunch the following day, at which the issue would be further discussed.

Mr. Goos said that, with respect to the proportion of the deviation to be financed, he could go along with Mr. Massé's position to rely on the prudence of management.

On phasing, he had no difficulty with the staff proposal except for the reference to six-monthly monitoring under specific arrangements, Mr. Goos continued. His preference would be to change the monitoring procedure for the purposes of contingency financing to quarterly monitoring.

As for symmetry, he had no difficulty with the staff proposals, and preferred option (ii)--which required repurchase of earlier contingency purchases in case of an unfavorable deviation being reversed during the baseline period after contingency purchases had been made. For cases in which favorable deviations occurred after a country had drawn on contingency financing, he could go along with option (iii)--to make provision for reduction of purchases under the associated arrangement, but allow members to have the option of repurchasing an equivalent amount of earlier contingency purchases.

Mr. Lim said that guidelines should be established for the appropriate proportion of the contingent deviation to be financed. The staff's comments on the desirability of smooth phasing in of adjustment and financing following an adverse shock were particularly relevant in that context. A range that was large enough to take into account specific country circumstances would appear to be appropriate.

On the question of symmetry, Mr. Lim agreed that, in principle, the focus should be on requiring a commensurate reduction in the use of Fund resources, either by the early repurchase of contingency resources or, if contingent financing had not already been drawn on, by reduced access under the associated arrangement. He recognized, however, that the raison d'être of the new facility was to facilitate adjustment, and there might be circumstances in which it would be best to allow favorable external shocks to be reflected in a more rapid buildup of reserves.

Mr. Posthumus said that, on the proportion of the deviation to be financed, he had been concerned about the adjustment element in the facility from the beginning. The statement by the Director of the Exchange and Trade Relations Department that 100 percent financing would be possible increased his concerns. The Fund ought to be protected against too many drawings under the facility, and there should be some limit to the contingency financing element. There could be exceptions allowed, perhaps by using the word "normally," but it should be a firm principle that any contingency would result in adjustment as well as financing.

On phasing, the procedure proposed by the staff omitted the idea of netting out contingencies against positive developments, Mr. Posthumus remarked. As he saw it, the point of contingency financing was to finance the increased payments or losses experienced by a country owing to external shocks that had already occurred; accordingly, drawings should be made ex post.

On symmetry, he had no problems with the staff proposal, Mr. Posthumus concluded.

Mr. Templeman said that he strongly supported the principle of an adjustment/financing mix in the event of an external shock. He was not convinced that it was necessary in each case to establish a specific proportion of financing at the beginning of a program; that could be determined on a case-by-case basis. However, if there was a consensus for such a general approach, he could go along with it. In any case, a decision would have to be taken at the time of activation. He expected that the balance between financing and adjustment would shift toward adjustment over time.

The procedures for activation remained to be dealt with, Mr. Templeman pointed out. At EBM/88/95, his chair had objected to the use of lapse of time approval, proposing that normal Board approval be required in all but the exceptional case that had been agreed to as part of the April consensus. His chair continued to hold that view and would be interested in hearing other Directors' comments.

As for phasing, he agreed with the approach set out in the staff statement, Mr. Templeman said. He also agreed with the staff proposal that contingency financing be disbursed on a six-monthly basis for programs with six-monthly monitoring. He continued to question the appropriateness of special arrangements for shocks that occurred late in a program.

On symmetry, he could support establishment of equal thresholds for both favorable and unfavorable shocks, expressed in terms of quotas, Mr. Templeman said. He would expect that most of the effects of the favorable shock would lead to a strengthening of reserves, but the option to require a reduction in Fund purchases under the associated arrangement should be preserved for specific cases. When an unfavorable deviation was reversed after a contingency drawing had been made, he would prefer that the contingency drawing be repurchased in order to re-establish contingency financing access. However, on a case-by-case basis, there could also be a reduction in purchases under the associated arrangement.

Mr. Toé said that regarding the proportion of the deviation to be financed, there was no valid reason for not covering the full amount of the compensable net deviation; he agreed with Mr. Sengupta on that point.

He had no difficulty with the rationale underlying the phasing of contingency purchases, Mr. Toé indicated. Since external shocks of different magnitudes could occur at any time during the program, the size of the various tranches should be left open to match the size of the deviation.

On symmetry, the effects of favorable developments should be used to foster the growth aspect of the country's program, Mr. Toé said. He had difficulty with the staff proposal to reduce purchases under the basic arrangement in such a situation, since the favorable developments might well be short lived. He could accept, under certain circumstances, use of the effect of a favorable deviation to replenish reserves. When contingency drawings were outstanding and favorable developments occurred, he would not require the country to make early repurchases, but instead would expect it to restore its access limit under the external contingency mechanism.

Mrs. Filardo said that members should have as clear an idea as possible of the measure of adjustment and financing that would be expected should a contingency arise. In that sense, she could endorse the staff comments regarding the phasing in of the appropriate mix. She would prefer not to establish a rigid guideline at present, but to leave that until the review of the facility.

On symmetry, she opposed the reduction of purchases under the basic arrangement should a favorable contingency arise. Early repurchases should be confined to previous drawings under the external contingency mechanism, and the building up of reserves should be a priority in all cases.

Mr. Hassan remarked that contingency financing should cover the full amount of deviations insofar as they were within the specified ceilings--either in relation to quotas or as a percentage of the financing available under the associated arrangement.

On phasing, the adoption of a predetermined approach might undermine the facility's intended objective, Mr. Hassan noted. Disbursement of contingency financing should be made in a timely manner.

On symmetry, he was of the view that the gain resulting from a favorable shock should be used to accumulate reserves and to increase development-related imports that contributed to improved growth prospects, Mr. Hassan remarked.

Mr. Fogelholm said that his chair was flexible on the question of the proportion of the deviation to be financed. He could go along with Mr. Massé's proposal to rely on the prudence of management.

On phasing, he could also go along with the staff proposal, Mr. Fogelholm indicated, although he had been under the impression that some ex post financing should occur when the contingency had actually taken place.

On symmetry, Mr. Fogelholm said that his preference was for the staff's option (i)--to reduce future purchases in case of a favorable development--though he could also go along with the option (iii), to make provision for a reduction of purchases under the associated arrangement. Only in special circumstances, when reserve levels were critical, should a buildup of reserves be allowed.

Mr. Rouai said that he could support the proposal to rely on management's prudence regarding the proportion of deviation to be financed, but he would urge flexibility in that respect.

On phasing, he could go along with the guidelines proposed by the staff, Mr. Rouai indicated. However, the adequacy of that approach could be best assessed on a case-by-case basis, taking into consideration the timing of the external shock.

On the issue of symmetry, Mr. Rouai said that member countries should be allowed to build up reserves to the level of the threshold, or even beyond that in cases in which reserves were particularly low. The reduction of future repurchases under the basic arrangement should only be considered once the reserves had reached an appropriate level. The third step would be to allow early repurchase of contingency drawings should the member have outstanding contingency purchases at the time of the favorable deviation.

Mr. Fayyad said that he would like to associate himself with Mr. Nimatallah's views on symmetry. On the proportion of the deviation to be financed and phasing, he had an open mind and was willing to support the consensus that might emerge.

Mr. Donoso remarked that, on the proportion of the deviation to be financed, he would prefer to have a concrete figure or range along the lines of Mr. Posthumus's proposal that a guideline be set. He would prefer that those figures be high, as suggested by Mr. Ismael.

He could go along with the staff proposals on phasing and on symmetry, Mr. Donoso indicated, except that he would prefer reserve buildup to be the initial reaction to favorable deviations.

Mr. de Groote said that he could agree with the emerging consensus on phasing and symmetry. On the proportion of the deviation to be financed, that could not be established in advance. That figure depended on the effect of the deviation on the country's balance of payments and public finances, as well as on the intensity of the corrective policies. Accordingly, the proportion should be decided on a case-by-case judgmental basis, instead of according to a quantitatively defined rule.

He was not clear on some Directors' reference to the trade-off between financing and adjustment, Mr. de Groote remarked. If a country suffered a substantial external shock that threatened the implementation of its program, it should receive adequate financing and, at the same time, take appropriate corrective measures to get the program on track. There seemed to be a direct relationship between adjustment and financing rather than a trade-off between the two.

Mr. Dai remarked that he was willing to rely on management's prudence with respect to the proportion of the deviation to be financed. On phasing, he had no difficulty with the staff's proposal, and on symmetry, he could go along with Mr. Nimatallah's position.

Mr. Donoso said that he had understood a decision on the adjustment/financing mix would be made at the time of designing the program and the external contingency mechanism, rather than at the time of activation of contingency financing. He had the impression that Mr. Templeman expected the deviation would be calculated at the time of the review, and not necessarily when the program was being put into place.

Mr. Templeman indicated that he had said he was in favor of the case-by-case approach at the beginning, but that he would be willing to go along with a consensus on a guideline. In any case, a de facto decision on the amount of financing allowed would have to be made at the time of the activation; that was a statement of fact rather than a proposal.

Mr. Donoso said that he agreed that the adjustment/financing mix should be determined on a case-by-case basis, but he considered that the proportion of financing should be selected prior to the occurrence of the deviation, when the arrangement was being implemented, and not at the time of the review.

The Director of the Exchange and Trade Relations Department remarked that the mix of adjustment and financing would have to be decided on both occasions. In general terms, the staff would seek to discuss that topic with the member country at the time of framing the economic program. However, it was impossible to envisage all the shocks that might occur, their degree of severity, and the form that they would take. Accordingly, the general principles agreed to at the time of Executive Board approval of the underlying arrangement would have to be readdressed at the time of activation and made more specific.

Mr. Donoso asked how, then, one could be assured of a symmetrical adjustment of the mix agreed to at the time of establishing the program in case of a possible deviation. The facility would be perceived as much more useful if the adjustment/financing mix could be defined in advance.

Mr. Marcel remarked that it was essential for the Board to have the final word on decisions regarding contingency financing; lapse of time decisions were not desirable.

Mr. Templeman said that he had been puzzled by the suggestion that the proportion of financing would be established twice--once ex ante and once at the time of the review. He had thought that the borrowing country would know how much financing was available to it in advance, whether that had been determined by a guideline or on a case-by-case basis. While it was true that decisions regarding policy could not be predetermined, financing could be decided in advance.

The Director of the Exchange and Trade Relations Department noted that the level of financing was tied to the degree of adjustment; if adjustment measures were decided at the time of the review, that affected the level of financing. Some flexibility with respect to the amount of financing available had to be allowed at the time of the activation since the staff was not able to foresee all possible shocks and their effects on the current account.

Mr. Donoso asked how symmetry in case of favorable deviations could be enforced if the set of policies was not predetermined.

The Director of the Exchange and Trade Relations Department said that while the principle of symmetry was accepted, the exact details on how it would be implemented might have to be decided after some experience had been gained with the new facility.

Mr. Sengupta noted that a country that experienced an unfavorable deviation would be compensated for the amount of that deviation beyond the threshold. Similarly, if it experienced a favorable deviation, the country would be expected to respond only for the amount of the deviation beyond the threshold. The problem was that if the favorable deviation was below the level of the threshold, the mix of adjustment and financing would not be clearly defined. In effect, symmetry introduced a further limitation on the proportion of the deviation to be financed. In the Articles of Agreement--Article V, Section 7--it was stated that when a country's balance of payments and reserve position improved it would be expected to make a repurchase. Was the staff proposing to change the Articles of Agreement? It appeared that the question of symmetry was already covered by them.

The Director of the Exchange and Trade Relations Department indicated that the staff would provide further elaboration on the issue of symmetry at a later time.

The Chairman proposed that Directors take up paragraphs 7 and 8.

The Director of the Exchange and Trade Relations Department remarked that, with hindsight, the staff would have drafted paragraph 7 somewhat differently. For example, the statement that "the fixed amount and the terms of resources available through the ESAF Trust to support enhanced structural adjustment facility arrangements would also appear to prohibit their use in contingency financing" was probably too strong. The difficulty was that both the structural and enhanced structural adjustment facilities had finite resources. In addition, the structural adjustment facility within the Special Disbursement Account required uniform access, which had led the staff to differentiate between the structural and the enhanced structural adjustment facilities. As he understood it, Directors wanted the structural adjustment facility to be included in contingency financing. That could be done by incorporating a review into the structural adjustment facility provisions, thus making that facility similar to the enhanced structural adjustment facility in terms of operation.

In response to a question from the Chairman, the Director of the Exchange and Trade Relations Department said that the staff had considered using a mix of structural and enhanced structural adjustment facility resources and ordinary resources to fund contingency financing for low income countries. However, it appeared that contingency financing of the structural adjustment facility would require the use of ordinary resources only. The staff had an obligation to provide identical amounts to all countries for which the allocation of resources under the structural adjustment facility had been approved by the Board. If resources were drawn from the Special Disbursement Account for contingencies, not all members would be eligible to use them, thus violating the obligation to draw upon the Account in a uniform manner.

To some extent, the enhanced structural adjustment facility could become its own external contingency mechanism given the substantial sum of resources allocated to that facility, the Director of the Exchange and Trade Relations Department noted. Therefore, the financial limits faced by the structural adjustment facility were not being experienced by the enhanced structural adjustment facility. In addition, there was a variability and flexibility in the amounts that could be allotted under the enhanced structural adjustment facility that did not exist under the structural adjustment facility. Also, there was a provision for differential amounts for members in different circumstances, which again was not possible under the structural adjustment facility.

The Chairman noted that the structural adjustment facility could be used in parallel with a stand-by arrangement. Accordingly, it seemed reasonable to use structural adjustment facility resources plus ordinary resources for contingency financing, if the repayment capacity of the country allowed that.

The Director of the Exchange and Trade Relations Department said that he had nothing to add on the attachment of external contingency mechanisms to the enhanced surveillance procedure. Executive Directors might want to return to that issue when they reviewed enhanced surveillance itself.

Mr. Hassan said that his authorities were concerned about the way in which arrangements under the structural and enhanced structural adjustment facilities were being handled. There seemed to be a tendency to treat such arrangements differently because they lacked the performance criteria of standard stand-by arrangements. The staff appeared to be suggesting that structural adjustment facility programs could benefit from external contingency financing only if benchmarks were re-established as performance criteria--in other words, if such programs were transformed into stand-by arrangements. If countries eligible for the structural adjustment facility needed the protection of contingency financing, it did not seem necessary to transform their programs into stand-by arrangements in order to provide such coverage. Activation of contingency financing under the structural and enhanced structural adjustment facilities could be based on ad hoc reviews called for by the member country.

On the financing of external contingency mechanisms associated with the structural and enhanced structural adjustment facilities, a number of Directors had expressed interest in the possibility of providing resources on concessional terms, Mr. Hassan recalled. He had expected that the staff paper would deal with that issue in more detail. As it was, the staff had outlined why it was difficult to use resources from the Special Disbursement Account and the structural adjustment facility to provide concessional financing. However, the staff should look into possible ways to reduce the cost of contingency financing for structural adjustment facility-eligible countries. One possibility would be to discuss with donors the use of enhanced structural adjustment facility subsidies to reduce the cost of ordinary resources used to finance external contingency mechanisms connected to programs under the structural and enhanced structural adjustment facilities.

The General Counsel pointed out that the subsidies to the ESAF Trust could only be used for loans that were extended under that facility. The enhanced structural adjustment facility had its own conditionality, being a combination of trust loans and structural adjustment facility loans with special rules.

Mr. Hassan remarked that, since the contingency financing would protect programs under the enhanced structural adjustment facility, perhaps donors would be willing to subsidize such financing.

The General Counsel pointed out that, in connection with the principle of uniformity of treatment under the external contingency mechanism, the question was whether the contingency mechanism should accompany only stand-by and extended arrangements--those that used the Fund's general resources--or whether it should also be available in association with structural and enhanced structural adjustment facility loans--which used resources from the Special Disbursement Account and/or the ESAF Trust. The contingency mechanism could be financed from the General Resources Account for stand-by and extended arrangements, from the Special Disbursement Account for structural adjustment facility arrangements, and from the ESAF Trust for enhanced structural adjustment facility arrangements, since there was complete separation of assets between the three accounts. However, that would lead to financing problems because, for example, there were probably not enough resources in the Special Disbursement Account to finance an external contingency mechanism for structural adjustment facility loans. Those necessary resources could be found in the General Resources Account, but the external contingency mechanism would then become subject to the rules of that Account, which included uniformity of access without distinction between developed and developing countries, whereas the Special Disbursement Account resources were available only to eligible developing countries.

The first problem in practice would be in connection with uniformity of conditionality, the General Counsel continued. The General Resources Account attached higher conditionality to upper credit tranche stand-by or extended arrangements. For the Special Disbursement Account and the ESAF Trust, the levels of conditionality differed between the structural and the enhanced structural adjustment facility. Therefore, a developing country that qualified for the structural adjustment facility would have greater access to contingency financing than either a developed country or a noneligible developing country would through the General Resources Account. In practice, given that higher level of conditionality in the upper credit tranche stand-by arrangements, access would not be uniform among countries. The solution would be to prespecify one level of conditionality for upper credit tranche stand-by and extended arrangements and arrangements under the structural and enhanced structural adjustment facilities.

The second problem would be uniformity of access, the General Counsel continued. If an overall ceiling were established in terms of quotas as had been the Fund's policy up to the present, uniform access would be achieved. However, if a subceiling was expressed in terms of the access under the associated arrangement, there was then a problem. For example, if a member qualified only for a stand-by arrangement, it would be subject to a ceiling of 70 percent of that arrangement. At the same time, a member that qualified for an arrangement under the structural adjustment facility as well as a stand-by arrangement would have access to 70 percent of the access under each arrangement. Since drawings on the structural and enhanced structural adjustment facilities were in addition to the use of ordinary resources, developing countries eligible for those facilities would have a higher level of access than other countries. The Board would have to avoid such nonuniformity of treatment by establishing an overall ceiling in terms of quotas. At the time of the individual arrangement, a subceiling could be determined by the Board, if that were deemed necessary.

Mr. Toé noted that it had already been agreed to fund external contingency mechanisms with ordinary resources. He did not see the point, therefore, of using resources from the Special Disbursement Account to finance external contingency mechanisms even if they were related to the structural or enhanced structural adjustment facilities. Perhaps the solution would be a subsidy account that could reduce the costs of contingency financing for countries that were eligible for arrangements under the structural or enhanced structural adjustment facilities.

The Chairman noted that the creation of a special subsidy account would add to the complexity of the new facility, and could perhaps be considered at a later date.

Mr. Dallara said that he perceived three different but related issues on the question of the structural and enhanced structural adjustment facilities. The first was whether members with arrangements under those facilities should be eligible for contingency financing; he considered that they should. The second was the issue of the adjustments that needed to be made in those arrangements in order to ensure that the programs were consistent with the modalities of contingency financing. For example, there would be a need for a midterm program review and for performance criteria instead of benchmarks.

The third question was that of financing, which he recognized was very complex, Mr. Dallara continued. On the issue of uniformity, which was complicated by the linkage of contingency access to the access under the underlying arrangement, guidelines other than the proposed 70 percent limit would have to be set. That limit could be used for all cases associated with stand-by and extended arrangements, with new guidelines being developed for cases associated with the structural or enhanced structural adjustment facilities. It might be possible to use either Special Disbursement Account or ESAF Trust resources to finance at least partially contingency financing for countries using the structural or enhanced structural adjustment facilities. That would clearly involve some revision of the structural adjustment facility's rules and might unduly delay operations of the enhanced structural adjustment facility. For the enhanced structural adjustment facility, perhaps the best that could be done would be to finance contingencies out of ordinary resources initially, while contemplating the possibility of allowing some use of enhanced structural adjustment facility resources together with ordinary resources at a later date. Use of those resources in connection with the structural adjustment facility did not seem to be as complicated, although it would require an adjustment in the principle of uniformity of access. Whether that rule could be changed was for the Fund as trustee to decide.

He was prepared to consider the use of contingency financing in conjunction with enhanced surveillance, Mr. Dallara indicated. However, some strengthening of enhanced surveillance would be required, since experience under that mechanism had been discouraging. For example, there would have to be a judgment by the Board in advance that the underlying program fully satisfied the requirements of the use of Fund resources in the upper credit tranches. Otherwise, the logic of the adjustment/financing mix associated with contingency arrangements would be undermined.

He was not convinced that contingency financing should be linked to any other basis, including Article IV consultations, Mr. Dallara concluded.

Mrs. Filardo said that she could associate herself with Mr. Dallara's remarks on the structural and enhanced structural adjustment facilities and on enhanced surveillance. She agreed with the staff's point that the incorporation of contingency financing under enhanced surveillance would require an increased Fund role in the design of the member's policy program. In addition, the duration of the Fund's commitment to contingency financing would have to be determined in advance, given the open-ended character of enhanced surveillance.

Mr. Goos indicated that he could not support the provision of contingency financing for arrangements under the structural adjustment facility, nor could he go along with using structural or enhanced structural adjustment facility resources for any contingency financing, for the reasons mentioned by the staff in its paper. Another argument against such funding was that the use of those resources would reduce the trust reserve that would be accumulated as protection for the enhanced structural adjustment facility contributions. If ways could be found to use general resources for contingency financing associated to the enhanced structural adjustment facility, he would have no problems. However, his authorities could not go along with the attachment of external contingency mechanisms to the structural adjustment facility; they saw no need for such financing.

As to enhanced surveillance, he would not object to a review in which contingency financing could be considered, Mr. Goos said. However, he was skeptical about the appropriateness of such an approach. While he agreed with Mr. Dallara's arguments for strengthening the enhanced surveillance procedure, he wondered what the difference would then be between enhanced surveillance and a traditional stand-by arrangement. Perhaps the possibility of a purely precautionary stand-by arrangement should be investigated, since that might meet the concerns of those who wanted to associate contingency financing with enhanced surveillance.

Mr. Cassell said that, in principle, he was in favor of having contingency financing available for the structural and enhanced structural adjustment facilities. He agreed with Mr. Goos that the case was stronger for the enhanced structural adjustment facility than for the structural adjustment facility. Given the nature of those facilities, he would like to have contingency financing be available on concessional terms.

However, he was concerned that if the issue of contingency financing in conjunction with those facilities were dealt with immediately, the activation of the compensatory and contingency financing facility might be delayed because of technical difficulties. Perhaps the question could be left under consideration for the time being, with the possibility of adding arrangements under the enhanced and structural adjustment facilities to the list of eligible arrangements at the time of the review of the new facility.

Mrs. Filardo remarked that the coverage of the structural and enhanced structural adjustment facilities could be included in the current decision with a judgment on the complexity of such coverage being made at the time of the review. At the very least, it should be agreed that that issue as well as the question of enhanced surveillance be pursued before the review of the compensatory and contingency financing facility.

Mr. Cassell said that while the experience with enhanced surveillance had not been satisfactory, he found the idea of a safety net for countries to be rather appealing. Therefore, he could go along with a review of enhanced surveillance. If it were decided to link contingency financing to enhanced surveillance procedures, with the Fund providing financial support, the nature of those procedures would have to change fundamentally. The Fund would have to make some judgment as to the adequacy of the policies to be pursued; a framework of conditionality would have to be introduced; and the time period of the Fund's commitment would have to be limited to a reasonable horizon.

Mr. Sengupta said that if contingency financing for the structural and enhanced structural adjustment facilities could be financed with ordinary resources, contingency financing should be linked to both facilities, and not just to the enhanced structural adjustment facility, since the two were essentially the same. The question that remained was whether a concessionary element could be introduced to those external contingency mechanisms, and that could be dealt with at a later stage. There should be no delay, however, in instituting contingency financing as such for the structural and enhanced structural adjustment facilities.

Mr. Cassell said that he agreed that those facilities should be provided with contingency financing, and that such financing should be on concessionary terms. However, it was not clear to him that even the first step could be taken immediately.

Mr. Sengupta said that if the intention was to convert enhanced surveillance into a traditional stand-by arrangement, the sense of enhanced surveillance would be lost. The goal was to protect the policies of a country, while protecting the Fund's resources, and certain steps had to be taken to afford such protection, but the full discipline of a stand-by arrangement might not be necessary. A thorough discussion of the principles involved was necessary.

Mr. Kyriazidis indicated that he was in agreement with Mr. Cassell and Mr. Sengupta on the inclusion of the structural and enhanced structural adjustment facilities in contingency financing. He was prepared to accept the tying of the contingency mechanism to those facilities as a first step, even if concessional resources were not available for the structural adjustment facility until the review of the compensatory contingency financing facility. He recognized that changes would have to be made in the monitoring procedures under the structural adjustment facility.

On the extension of external contingency mechanisms to enhanced surveillance, that would have to be discussed in the framework of the review of enhanced surveillance, Mr. Kyriazidis noted. As a preliminary remark, such extension would require stronger programs than had been the case to date.

Mr. Posthumus said that countries using the structural and enhanced structural adjustment facilities should be allowed to draw on the contingency element of the compensatory and contingency financing facility. He had considerable reservations on the attachment of contingency financing to enhanced surveillance because loosening contingency financing from the underlying financial arrangement would create an altogether different facility, which might replace the existing stand-by arrangement. Discussion of the issue could be postponed, but it did concern the compensatory and contingency financing facility more than it did the enhanced surveillance procedure, and therefore should be examined in conjunction with the new facility. The basic premise of contingency financing was that it protected the underlying arrangement. Enhanced surveillance had no underlying arrangement.

Mr. Fogelholm said that he could go along with the attachment of external contingency mechanisms to the structural and enhanced structural adjustment facilities after appropriate monitoring procedures had been established. However, such contingency financing should use only ordinary resources. On enhanced surveillance, he agreed with the staff proposal to postpone the discussion, and noted that problems had already been raised with respect to that approach.

Mr. Rouai said that, given his chair's reservation about the attachment of contingency financing to enhanced surveillance, perhaps that could be considered in the context of the next review of enhanced surveillance.

The Chairman suggested that the staff investigate further the issue of how contingencies financed by general resources could be used in conjunction with the structural and enhanced structural adjustment facilities; Directors appeared to have more problems with the former. On the use of contingencies with enhanced surveillance, some Directors appeared to be in favor while others had strong objections. That issue could be discussed at the time of the review of enhanced surveillance.

Directors could next consider the topics of coverage and calculation of the deviation, the Chairman proposed.

The Director of the Exchange and Trade Relations Department introduced the topic of coverage. On the subceiling of coverage of interest rates, he had a question for Executive Directors. The subceiling had originally been formulated in terms of a percentage of quota, but he was not sure that that was what Directors wanted. For example, if a country had a quota of 100 and it received the current average rate of access under a stand-by arrangement, which was 40, its external contingency financing access would be 28 percent of quota--70 percent of 40. If the subceiling of the coverage of interest rates were set at 35 percent, the country in question would have access to 35 percent of quota for the coverage of interest rates, which was more than the coverage of all other contingencies.

In addition, having a subceiling on the coverage of interest rates would add substantially to the complexity of the new facility, the Director pointed out. Separate accounts would have to be held for all contingency purchases and repurchases that were related to interest rate changes. If a minimum threshold were agreed to, the proportion of the threshold that was apportioned to interest rates would have to be decided; that proportion could change through time.

Another problem would arise if the interest rate deviation were negative but offset by favorable deviations in other areas, the Director indicated. For example, if the interest rate deviation exceeded 35 percent of quota, and other deviations largely, but not quite, offset that negative deviation, a decision would have to be made as to whether or not the remaining amount should be financed. Those difficulties were outlined in the footnote on "coverage" in the staff statement. If the conclusion was that the subceiling had not been reached in some cases, that could lead to accusations of discriminatory treatment between countries.

A fourth problem would be with multiyear arrangements, the Director continued. Presumably, the subset of 35 percent of quota interest rate coverage would have to be applied annually.

Finally, would the symmetry provision be limited to those favorable deviations in interest rates that exceeded 35 percent, the Director asked? In general, the introduction of a special subceiling for interest rate financing was tantamount to introducing a separate contingency facility for interest rates.

The practical difficulties of requiring parallel financing for interest rate coverage had been raised by Executive Directors, the Director of the Exchange and Trade Relations Department noted. The staff had suggested that the Fund avoid rigid rules but require parallel financing in cases in which the contingency financing made available by the Fund would be small in comparison to the effects of relatively small changes in international interest rates on the member's external position.

The Economic Counsellor and Director of the Research Department indicated that there had been broad support for coverage of a core set of variables--export earnings, import prices, and interest rates. The question that remained was whether all contingency mechanisms should be required to cover that specific core of variables, or whether there should be some flexibility in the choice among those three variables. The staff believed that a strong case could be made for the latter. For example, if interest rates were not a significant factor in a country's balance of payments, the authorities and the staff should have the flexibility to exclude interest rates for simplicity's sake. In another example, if 90 percent of a country's export receipts was concentrated in a small number of commodities, the staff and the authorities should perhaps have the ability to limit export coverage to those few commodities, thus ignoring the remaining 10 percent. Being obliged to cover the entire spectrum of exports could introduce much complexity with little payoff.

On the calculation of the deviation, the key question was how often the baseline period should be rebased, the Economic Counsellor remarked. If it were rebased too frequently, there would be no room for contingency mechanisms. On the other hand, if it were rebased at intervals that were too large, very large cumulative deviations would result. The staff's proposal was a compromise of 12 months.

As to whether a country that became eligible for a contingency financing under a Fund arrangement could also request compensatory financing on account of an export shortfall, the question raised by Mr. Sengupta in his statement, that was possible, subject to the rules of avoiding double compensation, the Economic Counsellor said. Mr. Sengupta had then noted that under the current proposals, when a country adopted an external contingency mechanism under a Fund-supported program, it had to prespecify exports as one of the variables covered by the contingency mechanism. In those circumstances, Mr. Sengupta had asked whether the country would lose the flexibility of choice between the two elements of the facility, and thus be put at a disadvantage.

The staff had indeed proposed that coverage under an arrangement be specified at the inception of the program, consistent with the principle that factors for which insurance was provided had to be specified in advance, the Economic Counsellor said. However, that in no way put the country at a disadvantage in the event that contingency deviations for exports and a compensatory financing shortfall occurred simultaneously. Indeed, application of the rules proposed by the staff to deal with double compensation would lead to the same quantitative result as if the country had been given the choice to opt for either coverage.

Mr. Sengupta said that there was a symmetry in the principle of avoiding double compensation in that if one had drawn from the compensatory financing facility, that amount would be netted against a country's contingency entitlement and vice versa. However, he had wanted a country to have the freedom of choice as to which element would cover its export shortfalls.

The Economic Counsellor observed that allowing a country to decide which element it would draw on after the export shortfall had occurred would be akin to taking out insurance after a disaster. The staff's proposal avoided that impression while ensuring that a country received the maximum amount of compensation from the two elements.

Mr. Posthumus suggested that the variables to be covered by the external contingency mechanism be defined as the three or four variables that together formed the highest percentage of the current account, rather than specifically mentioning the variables. That would, in most cases, lead to the same result as the staff proposal to cover export earnings, import prices, and interest rates, while introducing some degree of flexibility.

The coverage of interest rates should be limited more than the coverage of import prices and export receipts because interest rate increases would probably occur in many countries at the same time, Mr. Posthumus commented; a drain on the Fund's resources in such a case had to be avoided. The form that that limitation took was not important, but his authorities had difficulty accepting the coverage of interest rates and insisted that some sort of constraint be retained.

On the question of parallel contingency financing by official creditors, Mr. Posthumus noted that in debt rescheduling arrangements, official creditors usually tried to set fixed interest rates for the rescheduled amounts. Asking official creditors to join in parallel contingent financing would run against the heart of that approach. In most cases, governments already tried to arrange hedging and to avoid interest rate volatility. One of his objections to the new facility was that it favored short-term financing with floating rates, something that the Fund should not do.

The Chairman said that he agreed with Mr. Posthumus's concern that it would be difficult to involve official creditors in parallel contingency financing. He had had in mind involving only commercial creditors.

Mr. Goos remarked that his authorities, too, had been opposed to contingency financing for interest costs, and had moved their position substantially in an effort to find a compromise solution. At the Interim Committee meeting, his chair had expressed the view that interest cost financing would not be appropriate. The Bundesbank had even mentioned its strong reservations on the matter in its latest annual report. When he had last indicated his willingness to compromise, that had been on the basis of proposals for limitations--both in terms of quota and by the requirement of parallel financing--put forward by the U.S. chair.

Currently, the staff appeared to be withdrawing any limitations owing to objections by Executive Directors, Mr. Goos noted. On that basis, he could not support the contingency financing of interest costs. He understood the technical problems involved in limiting access in terms of quota, and accepted the argument that a 35 percent of quota access limit made little sense if one began on the basis of an average access of 40 percent under the underlying arrangement. However, that had to be considered in the context of the extended Fund facility, where the possibility for much higher access had been provided.

His chair was in favor of additional and more stringent limitations in terms of the quota access limit, Mr. Goos stressed, and also considered the prerequisite of parallel financing by commercial banks necessary. Perhaps a solution to the current difficult situation would be to take up Mr. Posthumus's proposal to postpone further consideration of interest rate coverage until the staff paper on possible hedging of interest rates was taken up. He would be happy to go along with interest rate financing, but only if the Board agreed to have the prerequisite of parallel financing as well as an additional limitation on the financing of interest rates.

Mr. Donoso asked whether the requirement of parallel financing had been part of the original compromise before the Interim Committee, or whether that had arisen in the discussion after the Interim Committee.

Mr. Posthumus remarked that Mr. Dallara had said, from the first discussion of interest rate contingencies, that he would be prepared to accept a ceiling on such financing. While the proposed limitations might not be specifically referred to in the statement to the Interim Committee, they were not a new concept. The Chairman, in his informal remarks of April 7 (see annex to Informal Session 88/5), had stated that a number of important matters remained to be discussed, including the extent and nature of coverage of interest rate developments.

Mr. Lim said that he had no difficulty with having a core set of three variables covered by all contingency mechanisms, with the inclusion, where warranted, of tourist receipts or migrant workers' remittances.

As to the limitations to be applied to the contingent financing of interest costs, Mr. Lim commented that the subceiling of 35 percent of quota seemed unnecessary in light of the other limitations on access. Similarly, while he recognized the important points of principle involved in the proposal, he did not consider a requirement of parallel commercial contingency financing as a precondition to Fund financing of interest costs to be practical. That said, it was clearly desirable for the Fund, in the context of its consultations with members on external contingency mechanisms, to encourage members to negotiate such parallel financing and to develop appropriate hedging strategies wherever possible. Evidence that a member had made a reasonable and concerted effort on both those fronts should be required by the Board on a case-by-case basis.

Mr. Fogelholm indicated that he had no difficulty with regard to the proposed three variables to be covered by contingency financing. The only problem that might arise was with regard to the degree of flexibility. If the choice of variables were left to the member, that member could hedge against the Fund. There should always be the possibility that the variables covered by a contingency mechanism could potentially offset each other, in order to achieve a netting-out effect.

His chair had difficulties with interest rate coverage and could go along with interest rate financing only on the condition that some limitation was introduced, Mr. Fogelholm said. His authorities preferred that such limitation be in the form of a parallel financing requirement, for two reasons. First, the banking community should not be given the impression that the Fund was changing the rules of the game; bank participation was requested in all cases of Fund financing, and was standard in all Fund programs. Second, it was in the interest of the banks themselves to participate in such parallel financing since that would prevent the program from going off track, thus increasing the possibility that they would be repaid.

Mr. Cassell observed that there was a policy trade-off between the need to avoid delays in contingency financing and the need to cover a sufficiently large proportion of a country's current account. The former requirement suggested that a core of inherently exogenous variables should be used. At the same time, however, broad coverage of the current account was necessary to ensure that the Fund would not be financing adverse deviations in one set of variables that were, in fact, offset by favorable developments in other variables that were not included in the core set. He was inclined toward eventual broader coverage, but perhaps operation of the new facility would best begin by concentrating on the three or four exogenous variables that had been specified, with a review being made in the light of experience as to whether wider coverage was desirable.

Among the core set of variables, he considered it imperative to include interest rates, Mr. Cassell stressed. He was greatly persuaded by the staff's points on the complexities of a 35 percent subceiling on the financing of interest rates. The access limitations that had already been included in the new facility created a built-in ceiling on the total exposure of the Fund's resources. Therefore, in the interest of simplicity, he would support dropping the 35 percent subceiling. He was in favor of obtaining parallel contingency financing whenever possible, but the question was whether or not that should be a requirement. To make parallel financing a precondition could unduly delay contingency financing. Accordingly, parallel financing was desirable, but should not be insisted upon in all cases. On the calculation of the deviation, he had no problem with the 12-month baseline suggested by the staff.

The Chairman noted that a decision by the Fund to finance a country's contingencies indicated that the Fund accepted more risk vis-à-vis that country. That, in turn, should facilitate the country's negotiations with commercial creditors.

Mr. Toé indicated that he favored contingency coverage beyond the three core variables mentioned by the staff to include interest rate fluctuations and, in cases in which foreign aid was of crucial importance to the success of the program, shortfalls in external financing. In the latter case, contingency purchases would play the role of bridge loans, being repurchased when foreign financing became available. In addition, the inclusion of export earnings in the coverage of external contingency mechanisms should not preclude the member's right to use the compensatory element. For the sake of simplicity, he did not favor a limitation on the financing of interest rate contingencies.

On the calculation of the deviation, given the sensitivity of the exchange rate variable, Mr. Toé said that he would prefer the current approach, whereby technical assumptions were made on future exchange rate developments. The staff could make what it called "true forecasts on future oil prices." On the length of the baseline, he could go along with the staff's suggestion of a 12-month projection period, which could be extended to 18 months when necessary to match the length of an 18-month arrangement.

Mr. Ismael said that, on coverage, he supported the principle of including a sufficiently large proportion of the exogenous components of the current account while avoiding undue complications. He preferred a case-by-case approach to the compulsory inclusion of a core subset of variables. Implicit in that preference was a wish for members to be able to choose the type of insurance they wanted rather than accepting all types of coverage in the core subset. The key issue in that regard was whether members could exclude export earnings if they felt that adequate coverage was already provided under the compensatory element--or indeed some other variable for which they did not consider that they required coverage. He was disappointed that fluctuations in the exchange rates of the major currencies would not be covered; that was one element that was clearly beyond the control of developing countries and yet had a large impact on debt-servicing costs.

He continued to oppose any restrictions on the coverage of interest rates, Mr. Ismael continued. A limitation of access or a requirement of parallel contingency financing for all cases would only make the external contingency mechanism ineffective. The staff proposal to require parallel financing in cases in which Fund financing was low relative to the impact of changes in interest rates would discriminate against the heavily indebted countries, which were most in need of the assurance provided by the external contingency mechanism.

Mr. Kyriazidis said that contingency coverage should be determined on a case-by-case basis, including the major elements of the current account. He could not go along with the coverage of capital flows or natural disasters.

With regard to limitations on interest rate contingency financing, Mr. Kyriazidis indicated that his authorities attached considerable importance to parallel financing. On the other hand, they agreed that a subceiling on interest rate financing would add complications without providing the Fund with additional safeguards. He had had the impression that the Fund would not be doing anything exceptional in asking for commitments for parallel financing. Nonofficial creditors could be asked at the time the arrangement was discussed to make parallel commitments with the Fund on a contingency basis. That, it seemed, had been done in the Mexican case. The Fund, therefore, would not be asking for parallel financing at the time the contingency arose; but rather as part of the original arrangement. He agreed that such a commitment could, and should, be asked only of nonofficial creditors, since official creditors were in a different category.

Mr. Marcel indicated that he would prefer interest rate coverage to be limited by a subceiling on access, which could be seen as a signal to the international financial community that the Fund was not prepared to fully compensate interest rate contingencies. With regard to the requirement of parallel contingency financing from commercial banks, he could endorse the staff view that rigidity had to be avoided as much as possible. The involvement of creditor banks was certainly highly desirable, provided that it was established in a flexible manner and did not lead to undue delays.

Mr. Hassan suggested that, in addition to the variables proposed by the staff, exogenous factors causing supply fluctuations--such as droughts--be included on a case-by-case basis, particularly for those countries in which such factors constituted major shocks and frequently led to the suspension of programs. In addition, while he understood that the Fund could not be expected to compensate for all capital inflow shortfalls, delays in aid disbursement and nonrealization of projected aid under Fund-supported programs had frequently resulted in the disruption of adjustment efforts, and there was a need to protect those programs against such shocks.

On the point raised by Mr. Sengupta in his statement, Mr. Hassan agreed that a country should have the freedom to decide whether an export shortfall was to be covered under the compensatory or the contingency element.

He did not consider that financing of interest rate contingencies should be limited to 35 percent of quota, Mr. Hassan commented, nor did he support the requirement of parallel contingency financing by commercial banks.

Mr. Dallara indicated that he continued to support a core set of the exogenous components of the three key external variables--export earnings, import prices, and interest rates--being covered in every case. He was not certain that that was the precise position of the staff. If too much case-by-case flexibility were allowed, the whole concept of netting out might be lost. It would not be consistent with the purposes of the new facility if a country could select an individual variable to be covered in light of an expectation of another variable turning out very well. The contingency element should cover only those variables that had a legitimate adverse effect on a country's external accounts on a net basis.

He still considered the coverage of interest rates to be critical, Mr. Dallara emphasized. He supported a sublimit on interest rate coverage, despite arguments that that would complicate the new facility, because of the positive effect that position had on the willingness of two Directors to go along with interest rate coverage in the first place. At the same time, he would welcome some clarification from Mr. Goos and Mr. Posthumus as to whether they considered parallel financing should be a condition for interest rate coverage or merely a goal that the Fund should encourage. If it were the latter, he fully agreed. He did have a problem with the concept of parallel financing being a prerequisite for interest rate coverage, since that had not been part of the pre-Interim Committee understandings.

He continued to have serious difficulty with the idea of capital movement or aid flow coverage, Mr. Dallara concluded. Indeed, it would be against U.S. legislation for him to vote for contingency financing in the Board if such financing were a bridge to U.S. aid disbursements.

The Chairman noted that the coverage of aid flows had not been discussed in great detail by the Board, but he saw many difficulties in principle with such coverage. The Fund could not bail out official donors, although he recognized the justification that aid disbursements were an element of a country's balance of payments.

Mr. Goos responded to Mr. Dallara that he considered parallel financing of interest costs a precondition of Fund contingency financing of that variable; it was a condition of his chair's consent to such financing. Whether or not parallel financing had been part of the pre-Interim Committee agreement, his chair now considered that it should be mandatory.

On the variables to be covered, Mr. Goos said that he had sympathy for the position that most variables should be covered, in order to avoid speculation against the Fund, but at the same time he understood the staff's point that there would always be a netting out of variables, regardless of the number chosen.

Mrs. Filardo commented that the variables covered by contingency financing should include the majority of those affecting a country's current account, with the selection of those variables being made on a case-by-case basis. She could not go along with any access limit on interest rate financing, and continued to view parallel financing as desirable but not essential.

Mr. Dai agreed that the coverage of variables should be determined on a case-by-case basis, rather than having a core set of variables. It might not be appropriate to include the standard three variables in all cases and a rigid formula should therefore be avoided. Some criterion could be established against which possible variables could be measured--for example, the impact of a variable on a country's current account. In that way, any concerns about a country speculating against the Fund would be eliminated. On the question of parallel financing, he could go along with Mr. Cassell's view that parallel financing should be worked toward, but should not be a precondition for contingency financing.

The staff appeared reluctant to consider the coverage of capital shortfalls because of the difficulty in assessing when such a shortfall was beyond the control of a country, Mr. Dai noted. However, special cases such as major shocks in the international financial market were clearly beyond the control of members and should be considered. Of course, the normal reluctance of commercial banks to provide capital should not be covered. On the calculation of the deviation, he could go along with the staff proposal.

The Chairman noted that it would be extremely difficult to decide when an international financial shortfall was serious enough to be covered by contingency financing. In addition, one had the problem of symmetry; if financial markets were doing well, should countries then be obliged to increase their reserves or make early repurchases?

Mr. Engert said that he was satisfied with the case-by-case approach in the selection of variables and did not see the need for a core subset. He did not consider a specific subceiling on interest rate coverage necessary, but would require parallel financing in cases in which interest rate changes were likely to have a significant impact on a member's external position. Natural disasters and capital shortfalls should not be covered.

Mr. Sengupta indicated that he supported some flexibility in the selection of the variables to be covered by contingency financing. The three variables chosen by Mr. Dallara were not necessarily relevant for all countries; those variables that covered most current account transactions should be included, thereby, some countries could include workers' remittances or tourism receipts as relevant variables. He was also in favor of including capital flows, but he understood that such a position did not have the Board's support.

On interest rate coverage, it seemed logical to have no constraints, but he was willing to accept some limitation if that made it possible for Directors to accept interest rate coverage at all, Mr. Sengupta said. If it came to that choice, he would prefer a subceiling on access to a requirement of parallel financing; having both limitations would be tantamount to not covering interest rate contingencies at all.

As he had set out in his statement, Mr. Sengupta commented, he felt strongly that a country should have the freedom to choose whether an export shortfall would be covered by the contingency or the compensatory element.

Mr. Donoso said that he could associate himself with Mr. Cassell's positions on the various issues, with some additional points on the question of parallel financing. He had difficulty with supporting such a requirement without knowing exactly what would be proposed to the commercial creditors and under which conditions they would participate in such parallel financing. Would the banks' involvement call for symmetry with regard to a country's balance of payments situation altogether, or only with respect to the interest rate variable? In addition, it was much more difficult for small countries to obtain bank financing than for larger countries. Accordingly, the Fund should ensure that the way in which banks were brought into parallel financing did not lend itself to discriminatory practices against small countries with respect to the amount and the velocity of financing. Because of those complex issues, he considered that interest rate financing should not be included in the current decision unless there was a clear definition of the banks' participation.

The Chairman remarked that while it would be difficult to prespecify the participation of commercial banks, the Fund should tell the banks that it expected them to contribute a multiple of the Fund's contingency financing of any external shocks, since the banks had as much interest in the success of the program as the Fund.

Mr. Donoso said he had understood that the Fund would call for the banks to contribute to interest rate contingencies alone, rather than to all variables, but he saw greater logic in the latter.

The Director of the Exchange and Trade Relations Department remarked that while the staff had referred to parallel financing for interest rate coverage in particular, the proposal was for banks to participate in the financing of all contingencies covered by the compensatory and contingency financing facility.

Mr. Donoso said that he considered it appropriate to have the banks be involved in the financing of all contingencies, but his concern was that the Fund avoid rigidity in applying guidelines on parallel financing, particularly with respect to small countries.

Mr. Fayyad remarked that coverage should be determined on a case-by-case basis with key variables being covered, including, where appropriate, workers' remittances and tourist receipts. Interest rates should also be covered and he agreed that rigid rules with respect to parallel financing should be avoided.

Mr. Fogelholm commented that the participation of banks in contingency financing clearly was necessary. If the Fund's contribution was very small in relation to the total shortfall, additional financing was necessary to avoid program failure. Accordingly, the Fund had to insist on parallel financing from other sources.

Mr. Rouai said that he could support the proposal to select the variables to be covered on a case-by-case basis. He continued to have reservations with regard to interest rate coverage and strongly supported a country's freedom to finance its export shortfalls through the compensatory element.

Mr. Zeas said that he agreed with the inclusion of the three variables set out by the staff, but regretted that exchange rates had not been taken into consideration. He entirely opposed the proposal to limit the financing of interest rate contingencies to 35 percent of quota. Such a limitation had not been included in the Managing Director's concluding remarks of April 7, 1988, and the introduction of such a limitation would violate the tightly negotiated compromise reflected in that statement. He also opposed a requirement of parallel financing of interest rate contingencies.

He had no difficulties with the staff's proposal on the calculation of the deviation, including the 12-month period for rebasing, Mr. Zeas remarked.

Mr. de Groote said that he could support Mr. Dallara on the question of coverage. On the subceiling and requirement of parallel financing in connection with interest rate coverage, he could go along with Mr. Cassell's position. If one of the limitations had to be accepted, he would select the subceiling as a second best.

The Chairman noted that the difficult question of coverage would be a topic of discussion at the Executive Directors' working lunch on the following day; management would consult with staff that evening on possible elements of a compromise. He saw much less difficulty, if any, on the calculation of the deviation.

He proposed that discussion of paragraph 11--the compensatory financing facility element--be resumed later, the Chairman said, and that Directors next consider paragraph 12--approval in principle, paragraph 13--cereal decision, and paragraph 14--transitional arrangements.

The Economic Counsellor said that while Directors' views on the question of approval in principle had already been expressed at previous meetings, Directors might wish to clarify their positions on whether or not they favored outright approval of compensatory financing requests when accompanied by an arrangement approved in principle. It would be useful if those Directors that favored outright approval also addressed the question of the proportion of the compensatory financing access and the conditions under which they would make that access available.

On the cereal decision, the Economic Counsellor remarked that it would be useful if Directors expressed their preference among the three proposed alternatives.

Finally, concerning transitional arrangements, two points had been added in the current staff statement, the Economic Counsellor pointed out. The first was the introduction of a transitional period during which each member would be granted at least 40 percent of quota access to contingency financing regardless of outstanding compensatory purchases. On the timing of the transition, the staff had changed its proposal to suggest that compensatory financing requests initiated before the approval of the new decision would be governed by the existing compensatory financing facility rules for a transitional period of three months after the approval of the new decision.

Mr. Dallara said that he could support the staff's position on the question of approval in principle and on the transitional arrangements. With respect to cereal access, he favored alternative (c). He did not support disbursement of compensatory financing upon approval in principle, regardless of a country's record of cooperation.

Mr. Comotto said that he could go along with the staff position on approval in principle. He preferred alternative (c) with regard to the cereal decision. On transitional arrangements, he had no difficulty with the staff proposals regarding access. On the timing, he could join a consensus in favor of a grace period of three months, but felt that there should be a fairly strict definition of what "substantive negotiation" meant. There might well be a rush by countries at the end of the three months to take advantage of generous transitional arrangements. He considered there to be a trade-off between flexibility in transitional access and flexibility in transitional timing; he could go along with one but not the other.

Mr. Toé said that he was in favor of outright approval of a compensatory financing request even if the associated arrangement was approved only in principle. On the cereal decision, he favored alternative (b), and he could support the staff proposal on transitional arrangements.

Mr. Marcel said that he strongly believed an arrangement approved in principle should be sufficient to meet the test of cooperation for the full amount of purchase under the compensatory financing element. On the cereal decision, he could support either alternative (a) or alternative (b), and he had no difficulty with the staff proposal on transitional arrangements.

Mr. Kyriazidis stated that approval in principle should be a sufficient condition for drawing on compensatory financing if prior actions were already in place and the country had a good record of cooperation. In other cases, it would be preferable for a country to achieve a critical mass of external financing before a drawing on the compensatory element was allowed. On the cereal decision, he supported alternative (b). As to the transitional arrangements, his chair supported Mr. Dallara's proposal, and agreed with the transitional period proposed by the staff.

Mr. Sengupta indicated that he considered approval in principle sufficient for compensatory financing drawings. His first preference with regard to the cereal decision was alternative (b), but he could also accept alternative (a). Alternative (c) went against the spirit of allowing simultaneous cereal and compensatory drawings. He could go along with the staff proposal on transitional arrangements.

Mr. Dai, Mr. Donoso, Mrs. Filardo, Mr. Zeas, and Mr. Rouai remarked that they could support the views expressed by Mr. Sengupta.

Mr. Ismael said that he could support the staff proposal on approval in principle, but in addition an outright compensatory financing purchase of at least the first tranche should be assured for all arrangements approved in principle. His preference on the cereal decision was for alternative (b), but he could accept alternative (a) if there was broad support for it. On transitional arrangements, he could support the staff proposal.

Mr. Engert said that he could support the staff's reasoning on approval in principle, but his authorities preferred that any outright purchase based on approval in principle be limited to the lower compensatory financing tranche. On the cereal decision, he favored alternative (c), and on transitional arrangements, he continued to support the staff's suggestion as set out in EBS/88/100 and in the staff statement made at EBM/88/94, that any discussions initiated after EBM/88/95 be governed by the provisions of the new decision, with discussions that had begun previously being subject to a three-month time limit for the conclusion of negotiations under the provisions of the existing decision.

Mr. Fayyad said that his chair considered approval in principle of an arrangement to be sufficient for compensatory financing disbursements. That should apply, at the minimum, to the first compensatory tranche, which meant 40 percent of quota for members with a satisfactory record of cooperation. On the cereal decision, he supported alternative (b), but could go along with alternative (a) as a second choice. He accepted the staff's proposal on transitional arrangements.

Mr. Goos said that he could go along with Mr. Dallara's positions on approval in principle and on the cereal decision. On the transitional arrangements, he could support both staff proposals.

Mr. Hassan said that approval in principle should be sufficient for outright purchase of the full amount of financing available under the compensatory element. On the cereal decision, he supported alternative (b), but could also go along with alternative (a). He supported the staff proposal on transitional arrangements, with the suggestion that the 3-month cutoff period be applied on a flexible basis since delays in application could be for reasons beyond the control of the authorities.

The Chairman noted that Mr. Comotto had recommended that flexibility not be permitted.

Mr. Fogelholm remarked that the distinction made by the staff on approval in principle had not been very clear; if a program was approved only in principle, drawings on the compensatory element should also be approved only in principle. On the cereal decision, he preferred alternative (c) but could go along with alternative (a). He could support the staff's proposal regarding transitional arrangements.

Mr. Posthumus said that he could now go along with the staff proposal on approval in principle, although he considered that if a country did not have sufficient financing assurances the Board could subsequently decide not to allow drawing of the first compensatory tranche. His chair's position continued to be that the 105 percent access limit should not be exceeded. Accordingly, he supported alternative (c) for the cereal decision, and on transitional arrangements he could not go along with the proposal to allow 40 percent contingency access regardless of a country's compensatory financing drawings; 105 percent was the total access limit.

Mr. Kyriazidis clarified that his position had been that a country which had passed a test of cooperation or taken prior actions should be allowed to draw the full compensatory financing access upon approval in principle.

Mr. Lim said that he was prepared to consider that an outright purchase of the compensatory component for members with a satisfactory record of cooperation or of the first tranche for those with an unsatisfactory record might be acceptable on the basis of prior actions. His constituency endorsed alternative (c) with regard to the cereal decision, but his Korean authorities could go along with alternative (a). On the question of transitional arrangements, he could support the staff proposal.

The Chairman remarked that the staff would open the Executive Directors' lunch with a summary of the Directors' positions, thereby allowing the Board to meet again on July 6 with the basis for a decision.

2. 1988 REGULAR ELECTION OF EXECUTIVE DIRECTORS - AD HOC COMMITTEE - COMPOSITION

The Chairman proposed that an ad hoc committee be established to draw up rules for the 1988 regular election of Executive Directors.

Without discussion, the Executive Board approved the following decision:

> An ad hoc committee on the Rules for the 1988 Regular Election of Executive Directors shall be established to propose rules for the conduct of the forthcoming regular election of Executive Directors and to examine and submit recommendations to the Executive Board on any related matters. The composition of the Committee shall be as follows: Mr. Ortiz, Chairman; Mr. Dallara, Mr. Finaish, Mr. Ismael, Mr. Mawakani, Mr. Ovi, Mrs. Ploix, and Mr. Rye.
>
> Adopted June 27, 1988

APPROVED: February 2, 1989

LEO VAN HOUTVEN
Secretary