MASTER FILES

ROOM C-120 04

NOT FOR PUBLIC USE

INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 85/142

3:00 p.m., September 13, 1985

J. de Larosière, Chairman
R. D. Erb, Deputy Managing Director

Executive Directors	Alternate Executive Directors
A. Alfidja	Mawakani Samba
C. H. Dallara	M. K. Bush
J. de Groote	
B. de Maulde	S. de Forges
M. Finaish	T. Alhaimus
H. Fujino	
G. Grosche	
	Jaafar A.
R. K. Joyce	L. Leonard
	J. Hospedales, Temporary
T. P. Lankester	T. A. Clark
H. Lundstrom	
E. I. M. Mtei	A. Abdallah
F. L. Nebbia	B. Jensen
Y. A. Nimatallah	J. E. Suraisry
P. Pérez	
J. J. Polak	
C. R. Rye	
G. Salehkhou	
A. K. Sengupta	A. S. Jayawardena
S. Zecchini	N. Coumbis
Zhang Z.	Jiang H.

L. Van Houtven, Secretary
B. J. Owen, Assistant

Also Present

IBRD: R. Agarwala, Special Office for African Affairs; D. R. Bock, Director, Financial Policy and Analysis Department; V. Dubey, Country Policy Department. Exchange and Trade Relations Department: C. D. Finch, Director; W. A. Beveridge, Deputy Director; M. Guitián, Deputy Director; J. T. Boorman, S. Kanesa-Thasan, N. Kirmani, G. G. Johnson, B. J. Nivollet. External Relations Department: A. F. Mohammed, Director. Legal Department: G. P. Nicoletopoulos, Director; J. G. Evans, Jr., Deputy General Counsel; S. A. Silard. Middle Eastern Department: J. G. Borpujari. Research Department: W. C. Hood, Economic Counsellor and Director. Secretary's Department: J. W. Lang, Jr., Deputy Secretary; A. P. Bhagwat. Treasurer's Department: W. O. Habermeier, Counsellor and Treasurer; D. Williams, Deputy Treasurer; J. E. Blalock, D. Gupta, T. Leddy, T. M. Tran, P. van den Boogaerde. Personal Assistant to the Managing Director: S. P. Collins. Advisors to Executive Directors: A. A. Agah, E. M. Ainley, P. E. Archibong, L. K. Doe, D. Hammann, S. M. Hassan, G. Nguyen, J.-C. Obame, G. W. K. Pickering, T. Sirivedhin, E. M. Taha, N. Toé, A. Vasudevan, M. A. Weitz, K. Yao. Assistants to Executive Directors: I. Angeloni, M. B. Chatah, J. de la Herrán, J. J. Dreizzen, G. Ercel, C. Flamant, S. Geadah, V. Govindarajan, N. Haque, G. D. Hodgson, L. Hubloue, Z. b. Ismail, H. Kobayashi, M. Lundsager, A. Mustafa, E. Olsen, J. Reddy, A. A. Scholten, B. Tamami, L. Tornetta, A. J. Tregilgas, E. L. Walker, B. D. White, Yang W., A. Yasseri.

1. USE OF RESOURCES OF SPECIAL DISBURSEMENT ACCOUNT ARISING FROM TERMINATION OF TRUST FUND - PRELIMINARY CONSIDERATIONS

The Executive Directors resumed from the previous meeting (EBM/85/141, 9/13/85) their consideration of a staff paper on preliminary considerations relating to the use of resources of the Special Disbursement Account arising from the termination of the Trust Fund (EBS/85/183, 8/6/85, and Cor. 1, 8/8/85).

Mr. Rye observed that he had approached the subject under discussion with a view to attempting to delineate those aspects that Ministers might most profitably address at the Seoul meetings. The five issues listed by the staff in the concluding section of its paper made a good starting point.

The staff had raised the question whether the Special Disbursement Account resources should be combined into a single facility, Mr. Rye went on. A possible prior question was whether those resources should be made available as loans or as grants. The Australian authorities, and possibly some other members of his constituency, would have a preference for grants; they had doubts about the wisdom of perpetuating Trust Fund-type assistance. He recognized that the 1980 decision might not have envisaged such an approach and that too much might have happened meanwhile to make it feasible. But if it were a realistic option, it would have two obvious advantages. First, many of the potential beneficiaries of the resources were already heavily indebted to official creditors; the extent to which such countries would benefit, if the Fund added to that debt, even on highly concessional terms, was open to question. Second, given the complexity of the issue, including the political dimensions, it would be worthwhile finding a way to avoid the need for the staff, management, the Executive Board, and the Board of Governors to spend an inordinate amount of time and energy on how to use Trust Fund resources every few years.

The resources of the Special Disbursement Account should be combined into a single new facility, Mr. Rye stated. The combination would have merit in terms both of administrative efficiency and of putting the relatively diminished resources to most effective use.

He was not in a position to pronounce in detail on the question of eligibility, Mr. Rye added, although his authorities had indicated support for two broad principles. First, the resources should be concentrated on the poorest members of the Fund; second, in observing that principle, the Fund should be flexible. He realized the potential for conflict between those two principles--namely, the more concentration, the less flexibility. What was needed was flexibility in eligibility but concentration where the need was greatest in actual disbursement. At the present stage he saw no ready solution to that problem; he was not sure that a formula approach was the answer, and it might be necessary to rely on the goodwill of low-income countries that had access to international capital markets--particularly the larger such countries--to stand aside from their entitlements.

The list of countries eligible for assistance from the International Development Association (IDA) might be an acceptable starting point in discussing eligibility, Mr. Rye considered. He would not favor the imposition of any arbitrary cutoff points, such as the upper limit of $550 per capita income canvassed in the staff paper. There, he parted company with Mr. Dallara: per capita income figures were notoriously unreliable, to cite only their well-known tendency to understate the incomes of countries with a small external sector. To use per capita income as a cutoff point would be bound to lead to invidious results. For example, the $550 limit would single out for exclusion three "IDA-only" countries, all of which happened to be open small island economies where estimates of income were less likely to be understated than to be inflated by large expatriate incomes. A formula that led to such a result should not be accepted.

Another more general issue in that respect was whether an eligible member should have a balance of payments need to be able to make actual use of the resources, Mr. Rye added. He himself would want to see such a requirement applied flexibly, in recognition of the pressing general needs of low-income countries. He would not like to see the exclusion of those countries that had managed their balance of payments in a prudent manner at the cost of short-term hardship, a potential difficulty with Mr. Dallara's approach--although his broad definition of balance of payments need might cover the point.

It was hard to come to firm conclusions on the details of collaboration with the World Bank at such an early stage, Mr. Rye considered. To what extent and in what form the Fund and Bank should collaborate was clearly very much dependent on what form the facility itself would take. Nevertheless, some issues of principle could be addressed immediately. First, he would be in favor of using Trust Fund resources to assist structural adjustment to as great an extent as possible. That pointed to the desirability--indeed the necessity--of close collaboration between the Fund and Bank in the design of adjustment programs. The more difficult questions concerned the coordination of financing. He took the view that each institution must remain responsible for its own resources and the policies applying to their disbursement. Mr. Dallara had taken a different view--one that certainly merited careful consideration--but one that he himself had recognized, in response to a question, might be open to the criticism that the bureaucratic entanglements in such close coordination between the two institutions' activities at such a high level might imperil the efficiency of the operation and perhaps even the objectives of the whole exercise.

On the vexed issue of conditionality, the preliminary views of the countries in his constituency varied rather widely, Mr. Rye noted. Personally, he would favor some form of ongoing conditionality--covering the period of disbursements--although he doubted whether it should go as far as that applied to upper credit tranche arrangements. That followed from his view that the countries to benefit from the resources should essentially be the poorest Fund members who by definition, compared with higher-income countries, had less room to maneuver in the short run. Accordingly, the emphasis in adjustment must fall to a greater extent on structural policies aimed at improving performance in the medium term. The corollary, of course, was that providers of concessional finance had obligations in terms of helping the poorest members through the early stages of the adjustment process.

The programs that the disbursement of resources from the Special Drawing Account would be supporting would, therefore, need to have a structural orientation focusing, inter alia, on producer prices, efficiency of parastatals, and appropriate investment programs, Mr. Rye continued. While he would not wish to rule out quantitative performance criteria as an element of the monitoring mechanisms, such programs by their very nature seemed to lend themselves better to monitoring by way of reviews and perhaps more qualitative performance criteria. He had in mind, for instance, requirements to wind up certain parastatals or parts of parastatals; or to maintain certain producer prices, or the exchange rate, in real terms. The underlying aim of such monitoring would not be to force the pace of adjustment but to ensure that the overall policy environment was as conducive as possible to the improvement of the country's performance in the medium term.

As for prolonged use of Fund resources and arrears to the Fund, his Australian authorities agreed with the staff on the need for stronger assurances from prolonged users of Fund resources of rapid progress toward balance of payments viability, and for members in arrears to the Fund to settle those arrears before access to Trust Fund resources would be granted, Mr. Rye stated. However, he could see the arguments for the opposite view, which had been expressed by Mr. Mtei. To the extent that prolonged use reflected an earlier lack of attention or commitment to structural adjustment, it would not seem wholly sensible to debar those same members from the use of resources that would be applied to rectifying the resulting deficiencies. Concerning members in arrears, he had come to the conclusion that the same considerations that had led to a policy of debarment from use of the Fund's general resources should apply to the use of Trust Fund resources. The prospect of access to such concessional resources would give members some incentive to settle arrears. Those arguments carried considerable weight, although again some case could be made for the opposing view. Allowing the resources of the Special Disbursement Account to be used to settle arrears might well give renewed heart and renewed incentive to those members genuinely trying to tackle their problems. The Board should think carefully before it denied such members that opportunity, which could be provided without risking any additional Fund resources. However, the adoption of a reasonably strong program--stronger than for countries current in their obligations to the Fund--should be mandatory. One proposal that might have certain attractions would be to allow members in arrears to use their share of resources from the Special Disbursement Account to settle those arrears but only subject to the adoption of a program involving sufficiently strong prior actions to demonstrate a high level of commitment to adjustment.

Mr. Grosche remarked that his authorities were in broad agreement with the analysis of the staff, whose conclusions were a good basis for the first round of the discussion. With Mr. Mtei, he believed that the consideration of the use of Trust Fund reflows should start from the observation that many low-income countries suffered from protracted economic difficulties that were larger than when the Trust Fund had first usefully made resources available to them. At the same time, fewer resources would become available through the Special Disbursement Account than the Trust Fund had had at its disposition because of the subsequent contributions that had been made to the Subsidy Account. Therefore, the most efficient use possible must be made of the SDR 2.7 billion that would eventually become available. Future disbursements should be made to countries experiencing protracted economic difficulties and with a view to fostering structural adjustment.

Referring to the more specific issues outlined in Section IV on modalities, Mr. Grosche continued, it would indeed be most desirable if eligibility to use the resources could be concentrated on those countries most in need of concessional assistance. One way to define that group of countries would be to limit eligibility to very low-income countries eligible to receive World Bank financing only on IDA terms--or IDA-only countries--an approach that had much appeal. A list of countries would provide a simple, clear-cut criterion for eligibility. A list could also be reviewed from time to time. However, he recognized that a number of members eligible to use the Trust Fund resources might have problems if they found themselves deleted from the list. One way to resolve the dilemma had been outlined by Mr. Dallara, whose proposal should be explored carefully. As he understood it, per capita income levels would not need to be lowered, nor would eligibility have to be restricted to IDA-only countries. Instead, the balance of payments need would be appropriately defined to make it absolutely clear that eligibility would be limited to those countries having protracted balance of payments problems, which would be characterized generally by the existence of difficulties in obtaining normal balance of payments financing. It would be helpful if the staff could provide some explanation of whether such an additional criterion could be properly defined and applied in a flexible, pragmatic way in distributing, say, on an annual basis, amounts that became available from the Special Disbursement Account.

As for conditionality, Mr. Grosche went on, it was generally agreed that the enormous internal and external imbalances faced by a large number of low-income countries called for a sustained adjustment effort with particular emphasis on structural policies. Resources from the Special Disbursement Account could be meaningfully employed for that purpose, particularly in those cases where the short-term monetary character of the Fund's regular resources or their prolonged use prohibited the Fund from committing large additional amounts of regular resources.

He could agree with the staff that it might be appropriate for annual programs to be developed within a more extended framework of structural adjustment, Mr. Grosche added. The staff had suggested three years, and Mr. Dallara two years; he himself had no strong views on the time frame. However, he had been interested in Mr. Dallara's idea of having such a program developed by a joint Bank-Fund mission, particularly if additional World Bank money could be generated in its support. Although he realized that a number of technical and administrative problems were associated with that idea, he was convinced that it deserved careful consideration.

Moreover, close surveillance should not be ruled out, Mr. Grosche remarked. In his view, the 1980 decision even allowed for disbursements in accordance with quantitative performance criteria. He could endorse broadly the guidelines in Section IV, paragraph 4 on the relationship between the use of resources of the Special Disbursement Account and the Fund's regular resources. However, he wished to emphasize that programs related to the use of Trust Fund reflows should not lead to a weakening of regular Fund adjustment programs. In other words, the latter programs should not be geared primarly to targets of a longer-term nature but to those of a developmental nature. Clarification of the staff's remarks in that respect would be helpful.

Referring to the topics on which the staff was seeking guidance, Mr. Grosche said that he endorsed the suggestion not to split the new resources into two separate facilities. It would be consistent with the 1980 decision to consolidate the amounts circulated; to do otherwise would risk dissipating the impact of those resources. Second, and for the same reason, there should be no recourse to the interest rate subsidy instrument to avoid depletion of the resources available for the special purpose under discussion. Finally, interest rates and the timing of repurchases could be similar to those for Trust Fund loans. Therefore, he was not in favor of Mr. Rye's idea of possibly extending those resources in the form of grants.

Mr. Jaafar considered that the staff had made a convincing case for setting up a special facility to make use of resources accruing to the Special Disbursement Account on behalf of deserving low-income countries. The basic elements of the facility had been well presented in the staff paper but they needed to be evaluated to see whether or not they would meet the agreed objectives. Therefore, the present exploratory and preliminary discussion should provide an opportunity for Executive Directors to evaluate the issues at hand from their own perspective before more definite steps were taken to create the facility. He hoped that at the conclusion of the meeting, the staff would have been given adequate guidelines for proposing more definite procedures for access to the Special Disbursement Account.

The list of countries in Table 2 would serve as a useful starting point for shortlisting eligible recipients of the resources of the Special Disbursement Account, although several observations were in order, Mr. Jaafar observed. First, it was well known that per capita income alone was not an adequate measure or indicator of economic development. In that respect, he fully agreed with Mr. Rye's remarks. Although the use of per capita income could narrow the scope of countries falling within the low-income category, it should be qualified by other criteria in order to determine which countries were in most need of special assistance.

Second, the novel concept of a country's creditworthiness vis-à-vis commercial banks, which the staff had adopted to qualify the per capita income criterion, gave him some difficulty, Mr. Jaafar noted. It was a concept related more to the standards used to distinguish members that were not creditworthy from the rest. It was essential to be certain about the standards applied in drawing up the list in Table 2 of the categories of countries eligible for World Bank loans: IBRD-only, IDA-only, or "blend." Creditworthiness, as it pertained to that list, was open to interpretation; for instance, it was debatable whether or not some of the countries excluded from the IDA category should belong to that group. If the concept of creditworthiness were to be used, it would have to be defined more clearly in operational terms. The guiding principle should remain a target group of countries with the greatest need. In addition, the idea that other low-income countries facing an emergency situation should also be eligible was one that he could fully support.

On a final point relating to the IDA-only countries, Mr. Jaafar said that he agreed with Mr. Mtei that there was little room for optimism. He had taken note especially of the long history of serious economic imbalances in many of those countries and their bleak prospects for recovery; notwithstanding the recent upturn in the world economy they faced fundamental problems relating more to the supply side in terms of the lack of infrastructure and of structural bottlenecks. Those problems certainly could not be dealt with adequately by demand management policies alone; a sustained effort would be required to bring about a more viable position in the medium term. Traditional remedies in the form of Fund-supported financial programs were too limited in scope unless supplemented by longer-term programs to tackle the structural and infrastructural issues. The World Bank definitely had a greater part to play in those countries than the Fund. Consequently, he was not averse to the idea of closer ties to the Bank in the coordination of programs. However, care would have to be taken not to duplicate the respective programs of the World Bank and the Fund. He was not sure whether it was necessary to go as far as Mr. Dallara had suggested and send a joint team to negotiate a single program, because the flexibility that had been maintained in Fund-Bank collaborative relationships would be lost.

It went without saying that the member should not be made to suffer any burden of cross conditionality as a result of closer coordination of programs between the two institutions, Mr. Jaafar added. As the nature of Fund-supported programs was essentially different from that of Bank programs, which should emphasize long-term development financing, the

Fund should take the lead in presenting its own program for adjustment in a medium-term context. The implementation of the Fund-supported program should not be conditional on there being a World Bank program, although it would be desirable as an objective to have a Bank program in operation in addition to that of the Fund.

Many of the countries in Table 2 had already made substantial use of the Fund's resources, some for a prolonged period of time and with no apparent success, Mr. Jaafar noted. For the most part, the imbalances of those countries were large and out of proportion to available resources. Therefore, it was important to emphasize that the reflows to the Trust Fund would not be large enough to provide meaningful assistance unless accompanied by other sources of financing. At the same time, prolonged use of resources should not be the issue, per se; a distinction should be made between those countries that had made a genuine effort to adjust and those that had failed. Only the latter group should have their individual situations looked at more carefully when access to the resources of the Special Disbursement Account--or use of any other Fund resources--was under consideration.

Another idea taken up in the staff paper, that of a catalytic role for Trust Fund reflows in attracting additional concessional aid from other lenders, merited closer examination, Mr. Jaafar considered. However, the commitment of resources from the Special Disbursement Account would have to be fairly adequate to be convincing. Certainly, an economic program supported by the Fund in association with assistance from the World Bank would be an excellent proposition provided it attracted assistance from other bilateral and multilateral sources, thereby providing a coherent package of adequate financing for a sufficient period of time.

Although the resources to become available were small in amount and would need to be channeled to the most needy countries, Mr. Jaafar remarked, it was not entirely clear to him whether there were any good reasons for consolidating the two amounts of SDR 1.5 billion and SDR 1.2 billion mentioned in the 1980 decision. He took it that at that time, two separate uses of the resources had been foreseen: one as Trust Fund-like assistance, and the other for use in special circumstances, such as emergencies or possibly to assist poor deserving members on humanitarian grounds. Moreover, some of the countries in the IDA-only group might be facing prospects that would not be alleviated in any meaningful way by the intended facility, either because they had an excessive financing gap or because the magnitude of their problems went beyond the scope of the proposed facility. Those were the target groups to which part of the resources could be applied. On pragmatic grounds, he could accept the consolidation of the two separate amounts. To preclude, a priori, access to those resources by some members in the poor country category would run the risk of violating the Fund's principle of equal treatment of all members. Keeping the two amounts separate to be used for different purposes--as originally intended under Decision No. 6704-(80/185) TR--would have the advantage of taking account of the varying circumstances of members and was worth examining in more detail.

The group of small-quota countries to which Mr. Rye had referred, including the small island economies, among which were to be found some of the least developed countries in spite of their per capita income, should also not be overlooked. In sum, while he was not opposed to keeping the two amounts separate, he had not yet been convinced that there was much to be gained in combining them into a single facility.

On the modalities outlined in Section IV of EBS/85/183, Mr. Jaafar said that he had no objection to periodic reviews. Annual reviews would seem satisfactory, but further details would have to be provided in order to establish the necessary linkage between the reviews and the calculation of maximum access in relation to quota.

On the criteria for eligibility, Mr. Jaafar said that he had no difficulty accepting the so-called meaningful market access criterion, as he had already mentioned. The criterion would have to be carefully defined in clear operational terms in order to avoid any arbitrariness in its application. He was prepared to look at the issue again, however, at a further review of the proposed facility.

As for adjustment programs, it would be appropriate to frame them in a medium-term context of, say, three years to begin with, Mr. Jaafar noted. Linking disbursements during the course of the program to observation of performance criteria appeared of dubious value in terms of the benefits to be derived unless there was sufficient information and data to warrant it. Therefore, he was not attracted to Mr. Dallara's proposal for quantified performance targets tied to semiannual reviews because it did not deal adequately with problems relating to data; further details of Mr. Dallara's proposal would be useful. The main difficulty arose from the possibility that some member countries within the group might not be able to supply timely information. In the absence of a better alternative, linking disbursements to annual program reviews appeared to be a more reasonable approach at the present time. Certainly, the problem would have to be looked at again after some experience had been gained in order to establish procedures for a subsequent period.

Use of the resources accruing to the Special Disbursement Account should not serve as a substitute for the use of the Fund's regular resources, Mr. Jaafar said. On a related matter, he also supported the view that if performance criteria were not applied universally to all users of resources under the Special Disbursement Account, they should not be applied specifically to prolonged users of Fund resources, in order to respect the principle of uniformity of treatment.

Finally, Mr. Jaafar said that the terms for use of the resources, as mentioned in the staff paper, seemed appropriate.

Mr. Polak stated that in considering what to do with the resources from Trust Fund loans that were being paid back, it might be of some use to recall the origin of the Trust Fund money: that part of the profits from the sale of gold by the Fund that was reserved for the poorest LDCs.

Two other segments of the gold profits--the part that went to all members and the part that went to all developing members--had been transferred to the beneficiaries without any conditionality and in fact as a final grant. By contrast, the Trust Fund money--the third segment of the Fund's gold profits that constituted a "third helping" from those profits for low-income countries--had been transferred as a loan, with some conditionality. It was the repayment of those loans by low-income countries that would permit the Fund to reuse those resources. In many cases, those repayments were being made by countries whose situation was more difficult than it had been when they received the original loan from the Trust Fund. That was one reason why the new disbursements should be made promptly, namely, beginning in the first half of 1986.

In the 1980 decision terminating the Trust Fund, the resources transferred to the Special Disbursement Account that were not used for the Subsidy Account had been split into two separate parts only in order to provide greater flexibility and against the preference of the Directors of developing countries, who had argued in favor of making the full amount available for operations similar to those of the Trust Fund, Mr. Polak recalled. His chair had shared the position of those Directors. Unless a clear case for flexibility was presented, he would continue to support a single fund approach and his comments on the use of the available Trust Fund money would refer to a combination of the two sums of SDR 1.5 billion and SDR 1.2 billion.

On the question of eligibility, he shared Mr. Mtei's views, Mr. Polak went on. The situation of a number of countries that had benefited from the original Trust Fund had improved importantly since 1975. Some of those countries had raised their income levels and others had acquired much greater creditworthiness in international markets. He also shared the staff's view that maximum benefit could be derived from a new round of use of the Trust Fund money only if it went to countries that still had very low incomes and that remained without access to capital markets, for the most part the IDA-only countries indicated in Table 2 of EBS/85/183. Indeed, it seemed to make questionable sense to start a new program of loans if the amounts were to flow back, in about the same proportions, to the countries making repayments, the new loans constituting a very small proportion of each country's quota a year. If it should prove impossible to reach agreement on extending the new loans to the shorter list of countries, it might be better simply to amend the 1980 decision and cancel all the Trust Fund repayment obligations.

However, he hoped that general agreement could be reached on the narrow list of users, Mr. Polak continued, with countries having somewhat higher per capita incomes or access to capital markets being prepared to agree not to claim access to the Trust Fund reflows in recognition of their relatively more favored position. Like Mr. Dallara, he realized that that decision might be difficult for some of those countries because it might be seen as having wider implications. Therefore, he would be prepared to accept any list so constructed that it would be as acceptable as possible for those countries, de facto, to forgo new credits. If the approach to that question suggested by Mr. Dallara proved workable, he would certainly support it. However, it would be wiser at the present stage not to put all the eggs in one basket.

The experience of the Fund suggested two possible ways of approaching the issue, Mr. Polak recalled. During the discussion in 1977 on the list of developing countries that would receive a direct distribution of gold profits, views in the Executive Board had been split on how broad that list should be, and in particular on the inclusion or exclusion of certain OPEC countries and some countries in Europe with median incomes. If those countries were excluded, it had been argued, the Trust Fund would have kept more of the gold profits, to the benefit of the poorest countries. The issue had been resolved ultimately by the acceptance of a broad list of eligible countries, once most of the countries in favor of that solution had committed themselves to transfer to the Trust Fund the amounts they were to receive in the direct distribution of gold profits. A second formula that might deserve consideration would be to hold that all members of the Fund found eligible to use the compensatory financing facility would be eligible to make use of Trust Fund reflows, provided it was understood from the start that the industrial countries, as defined when the decision on the compensatory financing of export fluctuations had been adopted, would not apply for the use of such resources.

The conditionality of the original Trust Fund loans had been light, Mr. Polak noted. The member had been required, as a minimum, to show that it was making a reasonable effort to strengthen its balance of payments position. The staff was right to point out in its paper that the countries to receive funds available from the Special Disbursement Account would need to make more than the usual reasonable effort to achieve balance of payments viability; they would need to undertake structural adjustment and to follow the right financial policies. For those eligible countries that already had effective Fund programs, the conditions of access to the Trust Fund reflows would raise no problem; they would obviously qualify and the additional resources that would flow to them would permit somewhat more rapid progress and somewhat less harsh adjustment toward economic viability. However, only 9 out of the nearly 50 IDA-only countries were at present in that position. For the countries that failed to address their financial problems--perhaps another 8 or 10 of the same list of countries could be considered to fall into that category--the decision was also clear cut; those countries would not qualify to use Trust Fund reflows. More than half of the list of countries would remain, a few of which might have policies that the Fund could consider broadly appropriate but the countries themselves might not have found it necessary or desirable to apply for a Fund-supported program. Those countries might be glad to seek even fairly demanding Trust Fund programs, given the financially attractive terms. The large majority of that middle group, however, could probably be described as including countries that were, in various degrees, seriously tackling their economic problems but with policies that would not fully qualify them for Fund programs. The issue of conditionality that would have to be decided as a matter of policy was whether countries of that group should be excluded from access to Trust Fund money until they came up with fully acceptable policies or whether the resources could be used to establish a "halfway house," which would provide the Fund with the opportunity to give some recognition to less than complete efforts while reserving the benefits of its regular resources for countries that did make the complete effort.

Two sets of questions were relevant in that connection, Mr. Polak added. First, would adjustment on balance be promoted by an intermediate approach, in line with the idea--familiar in the Fund--that there was some correlation between the amount of resources made available and the quality of the adjustment program--or would the only effect be to raise levels of consumption without enhancing countries' economic viability? Second, would the alternative of a high concentration of the reflows from the Trust Fund be desirable or acceptable? If the full SDR 2.7 billion were concentrated on, say, the most deserving dozen of the eligible countries, they might receive loans from that source amounting to 300 percent or 400 percent of quota in five years, while the others would receive nothing but would continue to repay past Trust Fund loans. Even if that example might be somewhat extreme, the excessive concentration of new credit was a matter for consideration.

On a related technical point, Mr. Polak said that he favored the basic idea in Section IV of the staff paper that countries' access to the new resources should, to the extent feasible, be laid down for several years ahead at the time when the member qualified, with some possible extension of the program in time if the member fell temporarily out of compliance. It had to be recognized, however, that even the tentative commitment of specific amounts for each member would not prove practicable if there was great uncertainty concerning the number of members that would qualify, unless it were accepted that a large part of the resources would in fact remain unused for many years.

For any Trust Fund programs that were agreed--whatever their degree of conditionality--he would favor half-yearly reviews, but not performance criteria such as were used in Fund stand-by or extended arrangements, Mr. Polak added.

He would have no difficulty with the terms proposed by the staff--ten-year loans at 1/2 percent interest--although he had noted Mr. Mtei's reminder that grants could be considered in using the second batch of money.

Despite his recognition of the importance of close collaboration with the Bank in connection with Trust Fund-related activities, as with most other activities of the Fund, Mr. Polak said that he took a cautious attitude toward the introduction of special provisions in that respect into the new Trust Fund loans. There would have to be certainty not only that closer collaboration with the Bank would be a desirable objective but that it would not make the functioning of the scheme unduly laborious.

The staff had proposed that countries in arrears to the Fund should not have access to Trust Fund resources, an approach that seemed correct in general, Mr. Polak commented. However, limited and controlled exceptions to that rule might be advantageous in instances where the member had taken a crucial step toward dealing with its arrears by adopting an adjustment program that would be acceptable to the Fund. Although the Fund did not negotiate programs with a member in arrears, negotiation of a Trust Fund program with such a member might perhaps be envisaged, if the program had the same policy content. The member's access to Trust Fund money would then be unblocked, and it could use the resources to pay its arrears to the Fund, thereby also unblocking the Fund's resources. What his very tentative suggestion amounted to was use of Trust Fund money, to which a member would otherwise have access, as bridging finance. He would not favor using for that purpose any Trust Fund money to which a member would not otherwise have access, which as he understood it was Mr. Mtei's idea, because that would involve discrimination in favor of members in arrears at the expense of members that remained current in their payments to the Fund.

Mr. Sengupta recalled that in April the Interim Committee had requested the Board to consider, in the light of its 1980 decision, the use of the resources to become available following repayment of loans made by the Trust Fund to help forward the adjustment process by providing assistance to low-income developing countries. The features of the 1980 decision were well known, and there were two outstanding issues that would have to be decided before the relevant provisions of that decision were implemented. In the first place, it would be essential to state clearly the arrangements similar to those set forth in the Trust Fund Instrument that should be applied for the use of SDR 1.5 billion of the resources of the Special Disbursement Account. Second, in respect of the use of the remainder of the assets of the Account, it would be necessary to determine the special terms that should be attached to such assistance and the difficult circumstances enabling a member to qualify for such assistance.

At the time of the Board discussion in 1980 that led to the termination of the Trust Fund and the transfer of resources to the Special Disbursement Account, Mr. Sengupta noted, his chair--along with other developing countries, as Mr. Polak had recalled--had supported the proposal to use the resources in that Account, net of payments made to the Supplementary Financing Facility Subsidy Account, to provide balance of payments assistance on concessional terms, and on a uniform basis to low-income developing countries in need of such assistance under arrangements similar to those set forth in the Trust Fund Instrument. In fact, he would prefer such a single Trust Fund-like loan arrangement to be in existence. But the 1980 decision had been a compromise which his chair had supported mainly because it provided the best way eventually to use all the resources in question under Trust Fund guidelines. However, he realized that the key words in the Interim Committee's request were "in the light of" the 1980 decision. Therefore, he would support any proposal permitting the use of SDR 1.5 billion on the same terms and conditions as those of the Trust Fund. The assistance should take the form of loans and not of the regular use of Fund resources. No conditionality should be attached to the loans, beyond what was necessary for the use of the first credit tranche. The loans should be provided on the basis of already existing Fund arrangements with members or of a yearly financial program of the kind that qualified countries to receive Trust Fund assistance. The countries that would be eligible for those loans would have to be the same as those in the Trust Fund list because they had been chosen on the basis of the most rational and equitable criterion of per capita income. In that connection, he noted that, as the Director of the Legal Department had explained when the 1980 decision had been adopted, the use of those resources remaining after provision had been made for the Subsidy Account could be determined by the Executive Board at a future date by adoption of new provisions. But the Director of the Legal Department had also made the pertinent remark that the 1980 decision involved a "promise by the Fund to use remaining resources in a specific way; the Fund would be acting in bad faith later to take a decision to reverse that promise, even if the subsequent decision was taken with a very high majority" (EBM/80/182, 12/12/80).

No specific provisions had been made in the 1980 decision with respect to the use of the remainder of the assets in the Special Disbursement Account, Mr. Sengupta mentioned. But the spirit of the decision had been to benefit developing countries with per capita incomes below a cut-off level. In extending help to members in difficult circumstances, it would also be possible to assist low-income members in difficulties caused by severe drought or by natural calamities, such as had been witnessed in sub-Saharan Africa. The problems of highly indebted countries could also be considered. According to his understanding, which had been confirmed after rereading the records of the Board discussion and especially the clarifications given by the Legal Department, that assistance could be more concessional in nature than Trust Fund assistance. It could even take the form of grants. Thus, no conditionality whatsoever would be needed. The assistance should be provided as soon as it was established that the circumstances of the low-income member were serious and were eroding its balance of payments position. If such a proposal was not acceptable, the least that could be done would be to provide concessional terms and conditions, as for Trust Fund loans, for low-income countries adversely affected by exogenous factors that had an impact on their balance of payments position.

The proposals by the staff were hardly touched by the spirit of the 1980 decision, Mr. Sengupta considered. He totally rejected the staff's suggestions regarding eligibility. The concept of creditworthiness had not been properly defined and was highly judgmental, especially in the case of low-income countries. The idea that a country could come to the Fund as a last resort only when denied access to all commercial banks went against the spirit of the Fund. In claiming to use the World Bank's classification of countries, and suggesting that eligibility should be confined to IDA-only countries, the staff was placing weight on creditworthiness rather than on per capita income. Countries with very low per capita incomes that had been eligible under the Trust Fund would be denied assistance if they acquired "blend" status by virtue of their strong adjustment policies, while countries with much larger per capita incomes could receive assistance as long as they were in the IDA-only category. He could not accept that proposal. It was also necessary to mention that "blend" countries were not denied IDA credit; they could also draw on IBRD credit. In any event, his chair would not condone unequal treatment of low-income members through the use of such concepts as creditworthiness, which were based largely on subjective judgments.

At the same time, he was conscious that some poor countries were in greater difficulties than others, Mr. Sengupta continued. Once eligibility had been defined, alternative ways could be devised to give first priority to those countries most in need of the resources, given the total amount of resources available. He had been interested in Mr. Dallara's suggestion that basic eligibility should be determined by per capita income while actual use was based on other criteria.

Since the idea was to allow funds to be used for the immediate purpose of meeting balance of payments crises of some of the eligible countries that were in extreme difficulty, Mr. Sengupta said, his Indian authorities would be willing to state that for the next two or three years--the period suggested by Mr. Dallara for a review--India would not draw on the resources, provided other countries similarly placed also stated that they would not make use of them.

If the concept introduced by Mr. Dallara of protracted balance of payments need implied an additional criterion to determine the intensity of the balance of payments need, he would not have much difficulty accepting it, Mr. Sengupta remarked. As he understood it, Mr. Dallara did not want to define the concept very precisely, a suggestion in which he saw a good deal of merit. But whatever the outcome, some window should be left open to enable a country that was poor by the standards both of per capita income and the level of development and that faced a very difficult balance of payments situation--for example, a sudden deterioration in the terms of trade or reserve position or in its balance of payments--to seek to use the resources to become available from Trust Fund reflows. He hoped that India would not fall in that category, but since it was after all among the poor countries, such a window should be provided.

While most countries, and not only low-income countries, needed to make structural adjustments, Mr. Sengupta observed, structural adjustment should not be a condition for qualifying for concessional assistance that applied only to the poor countries. Low-income countries should not be required first to make such structural adjustment efforts to correct their balance of payments position in order to seek concessional finance. What such countries needed most was concessional finance backed by a stabilization program. As long as a balance of payments need had been established and a stabilization program approved by the Fund, the eligible member should receive concessional resources without conditionality. Phasing of purchases, performance criteria, and program reviews should have no place in arrangements for providing concessional assistance to low-income countries. He also saw no need for the close coordination with the World Bank that had been suggested by the staff; the provisions for using the resources should be drawn up in accordance with the Articles of Agreement of the Fund and be consistent with the Fund's decisions. The result should not be a reduced flow of funds from other sources, nor should low-income members be debarred from using the resources on the grounds that they were prolonged users of the Fund's regular resources. In that connection, he would have difficulty in accepting Mr. Dallara's proposals in the precise form suggested, namely, a Fund-Bank program as a condition for such assistance. The resources should be disbursed exactly as they had been under the Trust Fund. The review concept introduced by Mr. Dallara suggested that there should be quantified targets judged in a qualitative manner on a judgmental basis, an idea that might be the beginning of a new approach to conditionality, which might have much greater applicability to the normal programs of the Fund.

Both Mr. Dallara and several other Executive Directors seemed to favor a periodic review of some kind of the whole matter of the use of Trust Fund reflows, Mr. Sengupta noted. Such a review would become necessary, after two or three years. As he had already mentioned, India might not need to invoke its right to draw on the Trust Fund reflows for some time, thereby permitting several other poor countries to receive more assistance, and he hoped that his authorities would be in a position to repeat their assurance on the occasion of a future review, if at that time they were in a similar situation. However, if similar assurances were not forthcoming from other countries, and if it was difficult to formalize the idea, he would be willing to accept Mr. Dallara's concept of protracted balance of payments need, provided it was loosely defined to cover exceptional situations in which countries in extreme balance of payments difficulties would be able to approach the Fund for assistance.

Mr. de Maulde remarked that his views on the subject under discussion should be considered personal and tentative. The outcome of the discussion would be a major element in the formulation of his authorities' final views.

Taking up the first of the three major issues that had been raised already--the issue of which countries should benefit from the resources--the fact that there was so much less money available than was needed argued for concentrating the resources on the neediest countries, Mr. de Maulde stated. At first sight, the proposal put forth in the staff paper for using the criterion of IDA-only countries appeared to fulfill that purpose. However, there were two drawbacks to that approach, the first being of a political nature and, in his view, entirely legitimate, and the second one being more practical. If countries that were not eligible at present for access to loans from the Trust Fund during the second period were to encounter sudden difficulties that did qualify them for access to the new resources, he understood that they would nevertheless not be able to draw under the staff's proposed system. He would await with great interest the reaction to Mr. Dallara's new proposal, which seemed to resolve that practical problem, if agreement could be reached on a formula that satisfied all the necessary requirements--practical, political, and legal.

On the second issue of how to distribute the resources, he had been pleasantly surprised by the general direction of Mr. Dallara's position on collaboration between the Fund and the World Bank, whereby both institutions would make concessional funds available in support of a growth-oriented program, Mr. de Maulde stated. Clearly, France was no longer alone in supporting such a stand. But what was more important was the implication that the U.S. authorities had finally assumed a more enlightened position on the amount of funds that all industrial countries should aim to channel through IDA. He did not want to plunge into the details of how such a common venture should work. It should suffice to say that the key objective should be resumed growth through policy reform. His authorities were fully prepared to contribute to the careful construction of a scheme to achieve those goals.

Third, on the conditionality issue, it was again necessary above all to be practical, Mr. de Maulde observed. Any formula that would result in the elimination of one third or even one half of, say, 50 countries would be entirely unrealistic, given the purpose of the Trust Fund and the pressing need of the poorest countries for concessional aid. Yet he feared that such a wholesale exclusion would be the inevitable outcome of the staff's proposals. At the same time, he was by no means in favor of an absence of conditionality and would not be at all shocked if some 3 to 5 countries with particularly bad records were prevented, on an annual basis, from using the new resources. As he had suggested, appropriate conditionality appeared to him to take the form of a macro-framework, provided by the Fund, to ensure that adequate efforts were made toward generating sufficient domestic savings, through the usual surveillance of the public sector, of monetary policy, and of the exchange rate. Within that framework, and supported by IDA loans extended by the World Bank, constructive action should be taken in the field of prices, investment, and management. The integrated program should be tailored in such a way as to help the highest possible number of eligible countries rather than to eliminate as many of them as possible.

Finally, Mr. de Maulde remarked, countries in arrears vis-à-vis the Fund should not be eligible to use the new Trust Fund resources, for obvious reasons of financial morality. At the same time, those countries should become eligible as soon as they were current in their obligations to the Fund.

Mr. Nimatallah expressed the hope that the Board, in what was a preliminary discussion, would indicate clearly to the staff the main issues to be examined further. The main objectives should be to ensure that Trust Fund reflows were used most effectively. In 1980, the Board had taken a decision on the use of SDR 1.5 billion of those reflows that made it clear that the amount should be channeled to poor, low-income developing members. On that basis, he would have no difficulty with a per capita income criterion for eligibility set at $550 or below. The 1980 decision left room for some flexibility on the actual use by countries of that SDR 1.5 billion, and given the overriding objective of using the money effectively, as well as the need to adapt the Trust Fund to the different world economic conditions, he could go along with the criteria proposed by Mr. Dallara--namely, that a member should have protracted balance of payments problems: little or no access to commercial finances; and be prepared to adopt a strong adjustment program.

On the use of the remaining SDR 1.2 billion, the 1980 decision provided somewhat wider scope to the Board, Mr. Nimatallah continued. The Fund, as trustee, could use that amount to provide balance of payments assistance on special terms to developing countries in difficult circumstances. He for one could not think of a more difficult circumstance than that of being in arrears to the Fund. As the Fund did not reschedule its members' debt, some countries in arrears did not qualify for a Fund-supported program and therefore could not be supported by the international financial community. Arrears were a growing problem to which the Board had not yet found an effective solution. The Board and the members concerned were trapped by procedures that were not producing positive results. A way out of that impasse was urgently needed, and one important way to assist low-income countries would be to make all or part of that SDR 1.2 billion available to help resolve the problem of arrears. He believed that that was possible and that the Executive Board should seize the opportunity to use those resources for that purpose. Therefore, he proposed that the Executive Board ask the staff to examine the question fully and to devise the necessary mechanism.

At the present stage, he himself had only one suggestion to make in that connection, Mr. Nimatallah added. Members in arrears that were prepared to adopt stronger adjustment programs might perhaps be given priority in the use of early Trust Fund reflows. The Fund and the member in arrears could work out an appropriate adjustment program to be supported by Trust Fund resources. Just before the program was approved, the member could arrange for a bridge loan to settle its arrears to the Fund. Once the program was approved by the Board, the member would immediately use the Trust Fund resources to pay back the bridge loan. Of course, the resources available to the member from the Trust Fund might be more, less, or equal to the amount needed to repay the bridge loan. But the important thing was that the member could conclude an adjustment program with the Fund that would attract financial assistance from other sources.

Giving such an opportunity to members in arrears to the Fund would have several advantages for both the member and the Fund, Mr. Nimatallah considered. The member would become current; it would have an adjustment program; and it would have plenty of time to repay the Trust Fund loan. The member would also be assisted, by the Fund acting as a catalyst, in obtaining additional financing from other sources. For its part, the Fund would regain its resources and would be better placed to assist other members. Generally, the Fund's financial position and image would be strengthened.

He understood from the staff that such a scheme could be made to work, Mr. Nimatallah mentioned. One possible drawback, of which he was very much aware, was that delinquent members might be seen as receiving relatively favorable treatment. However, his intention was not to reward the delinquents but rather to help the Board find a way to extricate them from an almost impossible situation and in a manner that protected the Fund and benefited other members as well. The particular members concerned would have to understand that they must take full advantage of such an important opportunity. And the Fund should make it clear to those members that their use of the Trust Fund resources, their repayment record, and their adjustment efforts would be taken into account in responding to possible future requests from those members for access to the general resources of the Fund.

He would like the staff to examine the matter and propose relevant criteria for implementing his proposal, Mr. Nimatallah said. In some cases, a member's problems and its financing needs might be more appropriately dealt with by the World Bank. He would also be willing to consider ways not dissimilar to Mr. Dallara's scheme of combining the use of Trust Fund reflows, the Fund's general resources, and the World Bank's structural adjustment resources, provided that the methods were workable and acceptable to the member concerned. In such cases, closer Fund-Bank coordination could be very helpful to the member.

There were, of course, other ways of using the SDR 1.2 billion, Mr. Nimatallah concluded. For example, the Fund could set aside all or part of that amount as a provision against overdue obligations. As soon as those overdue payments were cleared, the two amounts of SDR 1.2 billion and SDR 1.5 billion could be combined. Another way would be to move the SDR 1.2 billion fully or partly into the Fund's general resources and then to reserves. He hoped that the staff would examine those and other possibilities in its next paper. In any event, the Executive Board should not miss the opportunity to grapple with the problem of overdue payments to the Fund.

Mr. Zecchini said that it was necessary first to see what lessons could be drawn from the experience of the Trust Fund and what assistance developing countries needed at present in order to establish a basis from which to seek to improve past procedures. In retrospect, one of the weak points of the Trust Fund had been too easy access to its resources. Countries had not been required to take adequate adjustment measures under special Trust Fund programs or first credit tranche programs because the disbursement of the resources had not, in fact, been conditional upon the adoption of corrective measures. In the second period of the Trust Fund, assistance had been made subject to progress by the country in its adjustment efforts during the first period. However, the provision to that effect had not been rigorously applied. Greater emphasis on adjustment seemed justified at present, despite the improvement in the world economic situation, because of the exacerbation of the problems of many developing countries, which revealed the growing need for comprehensive corrective action.

As had been clearly pointed out in the staff report, the developing countries included in the group of those that were less creditworthy and had very low incomes had experienced great difficulties during 1977-84, Mr. Zecchini went on. Per capita incomes had decreased and external imbalances had worsened to such an extent that the performance of those countries appeared weaker than that of other developing countries. It was evident that that performance was imputable to structural weaknesses of their economies, including heavy reliance on a few primary or agricultural exports. The stagnation of official development assistance in real terms in the past few years had also increased the difficulties of the countries in question. In such a situation, the problem was not so much to restore access to bank credit as to find adequate financial resources on concessional terms. However, adjustment had also been lacking, due not only to restricted room for maneuver but to limited external pressure to adjust.

Moreover, the possibility of providing financial resources under regular Fund programs appeared limited, Mr. Zecchini commented. In some cases, Fund-supported programs had not had the desired adjustment effects, while in other cases, prolonged use of Fund resources had resulted. The predominantly structural nature of the problems to be resolved made the standard program supported by stand-by or extended arrangements ill suited for the purpose. Instead, the Fund could provide more appropriate financial assistance from the resources deriving from the Trust Fund or through a combination of such support with other resources provided either by the Fund or by other multinational institutions, such as IDA. The resources to which he referred included about SDR 1.2 billion to become available after the reimbursement of current Trust Fund loans and after the allocation of SDR 1.5 billion in balance of payments assistance to low-income developing countries in conformity with Decision No. 6704-(80/185) TR, adopted December 19, 1980. He was aware that that decision would apply also to the SDR 1.2 billion if the Executive Board took no other action by June 30, 1986.

On the specific modalities for the use of the Trust Fund resources, lower-income developing countries experiencing the greatest financial difficulties should be selected to reserve the available resources, Mr. Zecchini considered. In view of the limited amounts that would be available, it would seem best to concentrate the loans on a relatively small group of countries, avoiding an excessive fragmentation of resources. Furthermore, the availability of relatively larger sums for individual countries would facilitate their acceptance of more comprehensive adjustment measures. He would, therefore, support access only for those low-income countries that were normally eligible for loans from IDA, namely, IDA-only and "blend" countries as listed in Table 2 of EBS/85/183. However, if that criterion was followed, some large countries could drain more than half of the available resources, making it less possible to give adequate financial support to smaller countries in relatively more difficult situations. Those smaller countries did not have the same opportunity to tap the resources of financial markets or other financial institutions. Therefore, it would be desirable if those large countries voluntarily limited their resort to the Trust Fund resources, for instance, by giving assurances--even de facto assurances--that they would abstain from drawing, or would draw only under very exceptional circumstances and for amounts far below their entitlement.

The IDA-only criterion should be complemented by two others, which might be called qualifications on the use of the resources, namely, balance of payments need and the absence of overdue obligations to the Fund, Mr. Zecchini added. The latter qualification seemed indispensable because if the loans were made to countries in arrears, the proceeds could be used either to repay the Fund or for other purposes; neither outcome would be acceptable. In point of fact, such loans could be viewed as being in the primary interest of the Fund itself; otherwise, the Fund's exposure toward solvent countries would be increased, an equally undesirable outcome.

He saw no valid reason for envisaging different conditions or terms for use of the two amounts of SDR 1.5 billion and SDR 1.2 billion, Mr. Zecchini stated. The two amounts should be consolidated in a single new mechanism, which should be a permanent facility of a revolving nature, with the reimbursed resources used to provide new financial assistance on concessional terms to countries in need. There should be no need to take a further decision on the modalities for the use of those resources; however, a periodic review, say, every two to three years, would be advisable in order to adjust the modalities on the basis of past experience and the changing needs of potential borrowing countries.

It was necessary to avoid two extremes in attaching conditions to the loans, Mr. Zecchini remarked. On the one hand, the Fund could not continue to finance countries that did not adhere to sensible and balanced programs for economic development and, consequently, did not make the most appropriate use of the resources they received. On the other hand, the Fund could not apply the same degree of conditionality as in standard adjustment programs, with performance criteria, because the countries concerned would not be in a position either to accept the obligations or to fulfill them. The structural character of the problems of those countries make it necessary to grant the loans only to countries which presented multiyear programs that were sufficiently comprehensive and coherent to tackle some of the weaknesses--economic and in their balance of payments positions. The programs should be quantified to some extent in their main objectives and instruments and should deal explicitly with microeconomic in addition to the usual macroeconomic issues.

It was essential that the World Bank play a significant role in defining and financing the program, together with the Fund, Mr. Zecchini considered. Far from supporting cross conditionality, he nevertheless saw great value in setting up a framework for the tight coordination of the two institutions' activities. He had an open mind with respect to the possibility outlined by Mr. Dallara of a joint program by the Fund and the World Bank. However, it was clear to him that a joint program could be put in place only if it were financed also by new money provided by World Bank-related institutions. At the same time, he did not want to rule out the possibility of Trust Fund resources being used to support upper credit tranche programs for the purpose of lowering the overall borrowing cost for the country. In that case, the higher conditionality of standard programs should suffice. In any event, before the country was allowed to make additional drawings on Trust Fund resources, the monitoring of its performance should be strengthened while remaining mainly qualitative in its nature and flexible in its implementation.

Finally, access to the Trust Fund resources could be provided on a yearly basis, taking into account the list of eligible countries that had submitted requests and the resources available, Mr. Zecchini concluded. Although a uniform ratio of loans to quota within each year would represent an easy rule to apply, the possibility of linking the percentage of financing in terms of quota and the country's effort in complying with its program should not be discarded. However, there were insufficient reasons to change the other terms of Trust Fund loans.

In response to a question by Mr. Nimatallah, Mr. Zecchini explained that if the Fund were to permit members to use the Trust Fund reflows for the purpose of settling their arrears to the Fund, it would be perceived by the international community as intervening basically in its own interest. If instead the resources were made available to the same member, but for other purposes, the Fund would be increasing its exposure toward a country that was not in good standing, and that also would be inadmissible.

Mr. Nimatallah said that he disagreed that the Fund would be creating the impression of looking after its own interests. If a country with overdue payments to the Fund was given an opportunity to draw up a program, which it could discuss with the staff in an effort to conclude an arrangement with the Fund for the use not of its general resources but of its Trust Fund resources, it would be able to obtain assistance from other sources, thereby setting itself on a course of action that would help it to pay arrears falling due in the future.

Mr. Zecchini responded that the problem was perhaps one of timing. If a program supported by use of Trust Fund resources catalyzed additional financial assistance, the country should be asked first to become current with the Fund, which could then grant further support. It would be unacceptable for the Fund to risk tarnishing its public image by allowing a de facto exchange of bookkeeping entries whereby some new assets of the Trust Fund were used to cancel other assets in other books of the IMF. Many options were available to enable a country in arrears to become current and subsequently make use of Trust Fund reflows. But the principle that no member should be allowed to use the Fund's resources unless and until it was current on its obligations to the Fund must remain inviolable.

Mr. de Maulde noted that there was no doubt a general wish to refrain from lending to countries in arrears but at the same time a desire to help them become current. Without being too explicit at the present stage, it was possible to think of a number of bridging and other arrangements. Even though the Fund could not negotiate a program with countries in arrears, it was most definitely in close and constant touch with them. It was essential to retain a certain margin for constructive action.

Mr. Nimatallah said that he had envisaged greater flexibility in the use of Trust Fund reflows. The Executive Board's hands were tied when it had to deal with cases of overdue obligations in the sense that it could not grant any rescheduling even though it knew that the countries needed more time. Moving their indebtedness from the General Resources Account to the Trust Fund, of which the Fund was only the trustee, would give those countries the additional time they needed to work out and implement adjustment programs. To impose severe hardship as a condition for use of Trust Fund resources would inflict even greater discrimination on countries because many members that could be judged as suffering hardship were managing to repay the Fund.

Mr. de Groote asked what would happen if the Fund and the World Bank jointly negotiated a sound program with a country in arrears. The Executive Board of the World Bank might meet first and approve a structural adjustment loan; the country would settle its arrears to the Fund forthwith; and immediately thereafter, the Fund would make resources available to the country from the Trust Fund.

Mr. Zecchini reiterated his point that the issue was perhaps one of timing and of the mechanism by which the Fund would receive and disburse monies.

Mr. Polak commented that the issue did seem to him to be one of timing and of providing bridging finance. However, there was also the troubling question of moral hazard, in the sense that part of the Trust Fund reflows would be directed specifically toward countries in arrears.

Mr. Nimatallah stated that his proposal was intended only to give countries in arrears a certain priority in the use of the first reflows to the Trust Fund because of the growing intensity of the problem of overdue obligations. Later reflows would be available to all eligible countries in subsequent years from, say, 1987 onward. Some way had to be found to help the indebted countries, trapped in a situation in which nobody, including their bankers, could help them, even though everybody was anxious that they should reach agreement with the Fund on a program. The resources to become available from repayments to the Trust Fund could be used to create an opportunity for such countries to embark on a good course of action if they were willing and able to work out a program entitling them to use those resources on a priority basis. Such programs would have to be strong and based on stricter conditions than those usually applied to programs supported by use of the Fund's ordinary resources, especially if the country expected to continue to make use of the Trust Fund resources. The resources of the Trust Fund would continue to revolve as repayments were made, and the Fund would be in a better position to help other countries. The benefits would not flow specifically to individual countries, to the Fund, or to banks, but to all concerned. If anything was tarnishing the image of the Fund at present, it was the existence of overdue obligations, which might at any moment exceed $1 billion, a sizable amount. He saw nothing wrong with diverting the indebtedness of individual countries, with their agreement, from the General Resources Account to the Trust Fund, giving them the opportunity and time to work out their problems.

Mr. Dallara remarked that his authorities shared the concerns expressed by Mr. Nimatallah about the problem of arrears to the Fund. Nevertheless, he also appreciated some of the fundamental points made by Mr. Zecchini and by Mr. Polak. In addition, he was concerned about the effect of the approach suggested by Mr. Nimatallah on countries that might be eligible to use the Trust Fund resources but had maintained a current position with the Fund in face of serious difficulties. Another point that could not be overlooked was that countries with heavy overdue obligations to the Fund so far had not formulated the comprehensive sets of policies that would command the support of the international community and the Fund. If countries did manage to come up with acceptable programs, but the international community proved able through existing mechanisms to respond with adequate financial support, the Fund's own problems would become even more serious. However, at the present stage, he would prefer not to consider taking any action that could have potentially adverse effects, even though Mr. Nimatallah had made a number of interesting suggestions that warranted consideration.

The Chairman noted that one drawback to Mr. Nimatallah's suggestion was that giving priority in the use of Trust Fund reflows to countries with overdue obligations might encourage some countries to seek to qualify for such priority use. The basic position taken by Mr. Nimatallah was not however inconsistent with what other Directors had said or with the suggestions in the staff paper. If a country had met whatever conditions would justify its access to the resources of the Trust Fund--including balance of payments difficulties, which were sometimes associated with arrears--if the country could draw up a medium-term program for gradual adjustment, and if the necessary bridging finance could be catalyzed by the imminent emergence of such a program, then the provision of Trust Fund resources to such a country would not be inconsistent with the use of those resources to help repay arrears. The idea of priority in receiving Trust Fund assistance was to be avoided. Consideration also had to be given to the problem of the Fund's image, as Mr. Zecchini had stated. The Fund should not give the impression that it was making certain loans to members to enable them to repay other loans. As Mr. de Maulde had suggested, it should be possible, without attempting to be too precise at the present stage, to devise a mechanism geared to a meaningful program that would have the positive outcome that was universally desired.

Mr. Lankester observed that the redeployment of Trust Fund resources would give the Fund an opportunity to tackle--or help to tackle--the acute problems facing certain member countries. On most of the important issues, the staff paper pointed to a reasonable way forward. But the issues were difficult and complex, and it might not be possible at the present stage to agree on detailed proposals; however, certain general principles should be respected in framing such proposals. His authorities' thinking on objectives was very much in line with the approach outlined by Mr. Dallara although further consideration would need to be given to how his particular suggestions might work in practice.

On the question of consolidating the remaining Trust Fund resources, there were some obvious advantages, beside simple administrative convenience, in treating all remaining resources as a single amount, Mr. Lankester continued. In particular, a single common objective was more likely to be achieved--assuming one could be agreed--with a single pool of funds than with two separate pools containing smaller amounts devoted to somewhat different objectives. On the other hand, retaining two tranches might allow for greater flexibility, for instance, if eligibility differed with respect to each tranche. On the whole, consolidation was a secondary issue: a final conclusion could be reached only after a decision had been made on how and on what terms the reflows should be used.

On eligibility, he would emphasize the distinction between the concept of eligibility for drawing and what might be called the second stage of qualification for drawing, Mr. Lankester said. In practice, that distinction had become somewhat blurred in the operation of the original Trust Fund because most of the countries eligible to draw had, in fact, done so. But there seemed to be no reason why that pattern should be repeated under the new facility. In broad terms, the Trust Fund's resources should be used in future to provide the maximum benefit to the poorest countries most in need of financial support on concessional terms. That focus should mean in turn that the amounts available would be significant in relation to those countries' financing needs. One way to meet that objective would be through a narrow definition of eligibility. However, a sharp contraction of formal eligibility might cause difficulty for some present recipients of Trust Fund money whose financial position was relatively comfortable at present but might conceivably deteriorate seriously at some future time. If the deterioration was protracted, it would not necessarily be right to rule out drawings by those countries. As an alternative, therefore, he would be ready to consider some arrangement that limited access through the qualifications for drawing. Those qualifications should include--and on that point he agreed very much with Mr. Dallara--balance of payments need or, as Mr. Dallara had suggested, protracted balance of payments need, as well as the formulation of a clear program of adjustment. The statement by Mr. Sengupta on behalf of his Indian authorities was helpful in respect of defining the concept of balance of payments need. The concept of protracted balance of payments need was not easy to define. It was not a new one, and indeed it had been mentioned on page 16 of the staff paper; he hoped that the staff could clothe that concept with some operational meaning.

On the related question of conditionality, his authorities were concerned by the rather poor record of adjustment under previous Trust Fund loans, Mr. Lankester remarked. Under the new facility, disbursements should be attached to a clear program of adjustment which in formal terms might not go beyond so-called first tranche conditionality but should incorporate an important structural element designed in collaboration with the World Bank. Coordination with the Bank, which might well involve joint Fund-Bank missions, was an essential feature of the new arrangements. However, he wondered whether it was wise or practicable to envisage formal institutional involvement by the World Bank either in providing money or through a parallel discussion of programs in the Executive Board of the World Bank. Such involvement might unduly complicate the procedural arrangements when what was important was the World Bank's technical input on the structural aspects of each program. He had no fixed view yet on whether or not there should be parallel programs.

On terms, the preliminary view of his authorities was that the interest rate should be the same as for the Trust Fund loans, Mr. Lankester added. But with the emphasis on structural adjustment that his authorities supported, a longer maturity framework should not be ruled out.

On the question of monitoring, developments under a program should be assessed against a timetable of policy actions and against quantitative targets, although not in the form of strict performance criteria, Mr. Lankester said. Those policy actions and targets would probably need to extend over a longer period than that of a stand-by arrangement. The frequency of monitoring should not necessarily be the same as for a conventional Fund-supported program, and he could go along with the staff's suggestion of six-month reviews. In any event, successive tranches of Trust Fund disbursements should depend on some appraisal of performance.

On the whole, the arrangements for eligibility, qualification, conditionality, terms, and monitoring should be the same for all use of Trust Fund reflows, Mr. Lankester commented. Again, that would point to consolidation of the resources of the Trust Fund.

Finally, he had noted the suggestions that Trust Fund resources might somehow be used to alleviate the growing problem of arrears. Certainly, he hoped that the resources might help to prevent new cases of overdue obligations from arising. On the other hand, like Mr. Zecchini, he saw some difficulty in any procedure that gave the impression of Trust Fund money being used at the outset to help countries that had already fallen behind in their payments to the Fund. However, the issues raised were delicate and difficult to deal with. He had listened with great interest to Mr. Nimatallah's views, as well as to Mr. Polak's suggested modification of Mr. Nimatallah's proposal, and would like to give further consideration to such approaches.

Mr. Lundstrom observed that the reuse of the resources made available by the termination of the Trust Fund should be considered against the background depicted by Mr. Mtei, who had stressed the particularly serious and increasingly aggravating situation of the poorest countries: the less creditworthy, very low-income countries. Mr. Mtei had also recognized the need to ensure that structural adjustment in those countries actually was taking place. Those propositions should be two of the cornerstones of the new arrangement.

In passing, Mr. Lundstrom mentioned that Mr. Mtei should be commended for having put his views at the disposal of Executive Directors in advance of the meeting. It would probably increase the productivity of the Board's discussions on important policy issues if major statements, particularly those containing new ideas and suggestions, were given such advance distribution. The arrangements for use of Trust Fund resources that were outlined in the staff paper should not be considered as final, full-fledged proposals. Also, many supplementary suggestions had been made during the present discussion, particularly by Mr. Dallara. Consequently, his own remarks would be preliminary and exploratory, and made partly from a personal point of view.

Both the Trust Fund in its original form and the new outline presented by the staff raised interesting questions about the Fund's functions and about the evolution of cooperation with the World Bank in a longer-term context, Mr. Lundstrom added. His authorities took a generally positive view of the modalities of the new arrangement although they felt that the fundamental issues raised could not be covered at the present meeting and that the decision aimed at might have to be of an ad hoc character and be subject to review after a reasonable period of time.

It would be appropriate to employ all the funds resulting from the termination of the Trust Fund under a single arrangement, Mr. Lundstrom considered. Not everybody shared that view but he submitted that it was necessary to refrain from complicating further--and unnecessarily--an already too complex structure of Fund facilities.

Eligibility, obviously, was a more sensitive question, Mr. Lundstrom continued. It might become a little less sensitive if a distinction were made between eligibility in principle and what might be called eligibility in practice. In principle, and formally, there should be as few restrictions on eligibility as possible. It seemed natural to maintain the same basic criterion for eligibility as for the original Trust Fund, namely, the same maximum per capita income level as that applied to IDA eligibility. All low-income countries listed in Table 2 thus would be formally eligible.

In practice, stricter criteria would have to be applied, corresponding to Mr. Dallara's qualification criteria, Mr. Lundstrom said. One such criterion might be a lower maximum per capita income level, perhaps the one of $550 suggested in the staff paper. As for the other qualifying criteria that would have to be applied, he had no difficulties with the ones proposed by the staff: protracted balance of payments problems, continuing need for additional financing on concessional terms, and serious limitations on access to other sources of financing. In effect, there would be a de facto limitation to, for the most part, IDA-only countries. In view of the precarious situation and great needs of those countries, such a limitation seemed reasonable, but with three provisos. As already suggested, no low-income countries should be formally excluded; it should be possible to make exceptions for countries in emergency circumstances; and the criteria should be reviewed after a few years.

The objection might be raised that the requirement of protracted balance of payments problems might be both difficult to apply and unnecessary, since it was largely covered by the criterion of continuing need and the criterion of serious limitations on access to other financing, Mr. Lundstrom noted. It had also been maintained that countries without balance of payments problems would be put at a disadvantage if the existence of such problems were to constitute a criterion. He was not convinced by those arguments. Access to financing under the new arrangement should not be considered as an undeserved benefit because it would be linked to economic programs requiring arduous adjustment efforts. Accordingly, there would be a trade-off between the financial relief obtained and the demands of the structural adjustment undertaken. Having listened to Mr. Sengupta's constructive views on how the eligibility question might be handled, he felt confident that a pragmatic and generally acceptable solution would be found.

Concerning the type of economic programs to be supported by the new facility and the scope for cooperation with the World Bank in that context, his authorities agreed with the staff that the programs should be developed within an extended framework of structural adjustment and should be designed in close coordination with the Bank, Mr. Lundstrom stated. The two institutions should endeavor to establish a common view on the economic problems and policies of the countries concerned. Each institution should bring its own expertise to bear on the situation with which the country was confronted; but the two institutions together should try to develop a common country-oriented approach, so that the problems were considered from the country's and less from each institution's point of view. That seemed to require more far-reaching cooperation on all levels between the two institutions than there was at present, although it had to be recognized that that cooperation was already being strengthened.

He had been attracted personally by Mr. Dallara's idea of truly joint Fund-Bank missions rather than Fund missions with Bank participation and vice versa, Mr. Lundstrom added. There were obvious objections--as there usually were against changes in established practices--but the possibility was well worth considering. He had the same positive reaction to Mr. Dallara's somewhat bolder suggestion that such joint missions should produce joint reports to be submitted to the two Boards simultaneously. In the countries that were likely to qualify to use Trust Fund resources under the new facility, the structural problems with which the Fund was principally concerned were so interwoven with the structural problems that were mainly in the Bank's domain that it would not seem very useful to separate them; those problems should be considered in the same context. Nevertheless, extensive formalization of close Fund-Bank cooperation would not seem appropriate at the present stage; general guidelines should suffice.

Additional infusions of financial resources, both from the World Bank and other multilateral institutions, as well as from bilateral donors, would be desirable, Mr. Lundstrom went on. The prospects for the provision of additional financial contributions ought to be improved, since the existence of Fund-supported programs tended to increase confidence in a country's capacity to cope with its economic problems and to use additional external resources productively. But he would not go so far as to make concurrent IDA credits or financing under the Special Facility for Sub-Saharan Africa a precondition in every instance for access to the new facility and for the formulation of an integrated Fund-Bank program.

As for the monitoring mechanism, or more precisely, whether or not disbursements should be linked to performance criteria or program reviews, Mr. Lundstrom said that he had a preference for the latter more flexible approach, given the type of problems to be dealt with and the character of the programs likely to be involved.

On the closely connected question of the relationship of the new facility to the use of the Fund's regular resources, Mr. Lundstrom added, his authorities were in broad agreement with the modalities suggested in Section IV, paragraph 4 of the staff paper, with two points of emphasis. First, the automatic qualification of a member (if it had a stand-by or extended arrangement) for the disbursement of Trust Fund resources, should presuppose the existence or formulation of a well-defined structural adjustment program in the context of the stand-by or extended arrangement. Second, access to the new Trust Fund arrangement by prolonged users of Fund resources should also require the existence of such an adjustment program. Similar provisions should apply to members in arrears that would permit them also to qualify for use of the resources available under the new facility. As the Chairman had observed at the previous meeting, the question of how to deal with members in arrears was mainly a question of how to tackle the issue of priorities; the intention was not simply to exclude members in arrears a priori from using the new resources. In that connection, it might be noted that in the original Trust Fund, it was possible for countries undergoing serious hardship to request a limited extension of the period for repayment.

On the related problem of conditionality, the staff paper was not totally clear, Mr. Lundstrom commented. However, a case seemed to have been made for a strengthening of the first credit tranche conditionality applied so far, a case that his constituency felt was a good one. But when it came to the actual meaning and application of such conditionality, it would probably be necessary to allow for considerable flexibility, due to the simple fact that various countries' situations differed widely. The overriding concern should be to provide relief to the poorest and most needy countries on terms that assured that effective structural adjustment would actually take place.

Mr. Hospedales said that his chair welcomed the preliminary discussion on the use of resources of the Special Disbursement Account deriving from the termination of the Trust Fund, especially in the context of the present plight of low-income developing countries. The insight offered by Mr. Mtei into the problems of those countries had been instructive. Such considerations had been given appropriate weight at the time when the Board, out of concern for the scale and severity of the financial position of low-income countries, coupled with the desire to return part of the Fund's gold to members, had prompted the establishment of the Trust Fund in 1976. The main features applying to use of the Trust Fund resources had been low conditionality, high concessionality, and the existence of an overall adjustment program. Since that time, low-income countries had been plagued increasingly by severe economic and financial difficulties. In sub-Saharan Africa, those difficulties had been compounded by the devastating effects of drought. He could not agree more with the staff's conclusion that there seemed to be little prospect for those countries to return to balance of payments viability and renewed economic growth in the foreseeable future. Their precarious situation called for concerted international action, and substantial flows of concessional assistance would be an indispensable first requirement.

In addition, given the marginal benefits being derived by low-income countries from world economic recovery and trade expansion--which were in any case hardly on a satisfactory scale--and the continuing decline in real net concessional transfers, as well as the urgent need to revive the momentum of growth, his chair fully supported use of the resources of the Special Disbursement Account for low-income countries as envisaged in the decision terminating the Trust Fund, Mr. Hospedales stated. In other words, SDR 1.5 billion should be disbursed on terms similar to those of the Trust Fund, and SDR 1.2 billion should be made available under more liberal terms and conditions, as envisaged in Paragraph 3(b) of Decision No. 6704-(80/185) TR, in accordance with Article V, Section 12(f)(ii). The decision to use SDR 1.2 billion in that way would require an 85 percent majority, in the absence of which that amount would be used on the same terms as the SDR 1.5 billion. Obviously, the 1980 decision could be changed, also by an 85 percent majority of the voting power. Although moderate, the quantum of resources at stake could contribute to the gap-filling exercise for the low-income countries and in the process should play a significant catalytic role.

The Fund had acquired considerable experience and knowledge of the adjustment process in low-income countries over the past decade, Mr. Hospedales remarked. Discussions within the Executive Board had served to generate a broad consensus on the appropriate modalities of financial programs for those countries. Certain principles could be drawn up on the basis of that experience and knowledge to govern the disbursement of the resources. Differences of emphasis on certain issues would emerge but he felt sure that those could be resolved in the present round of preliminary discussions.

The modest scale of resources available--SDR 2.7 billion--measured against the magnitude of the imbalances made it imperative that their use be strategic, selective, and highly concessional, Mr. Hospedales continued. For that reason, it was doubtful whether the best way to use those resources was the one suggested by the staff, namely, that SDR 1.5 billion and the estimated SDR 1.2 billion should necessarily be disbursed under the same rules. It was not in the international community's interest to forgo at the present stage the greater flexibility offered by the provision of Article V, Section 12(f)(ii), which would make even grants possible. It should, therefore, be decided that the estimated SDR 1.2 billion could be allocated on different, and more liberal, terms than the SDR 1.5 billion. The decision could specify either the terms and conditions of use of the SDR 1.2 billion or simply set that amount apart for use on more liberal terms than the SDR 1.5 billion. The decision could also provide that any sums not used in accordance with it by a certain date--perhaps within two years--should be merged into the SDR 1.5 billion tranche.

The funds to become available under both tranches should be reserved for the poorer developing countries, Mr. Hospedales went on. Loan commitments could be made to eligible countries for a series of years, subject to balance of payments need and other conditions, but also for emergency relief. The staff had suggested that disbursements should be made on a half-yearly basis, subject to performance criteria or reviews. The staff itself showed a preference for the latter, except where a country had little or no scope for using the Fund's general resources because it was a prolonged user whose previous record of adjustment called into question the temporary nature of its use of additional general resources. There had been no performance criteria attached to Trust Fund loans and to introduce them for use of Trust Fund reflows would introduce a dissimilarity that was unacceptable. He did not feel that half-yearly conditional disbursements would be similar to Trust Fund conditions, although he agreed that annual disbursements should require an annual program and first credit tranche conditionality.

The meaning of first credit tranche conditionality would have to be clarified, Mr. Hospedales added. The reference in paragraph 3(b) of the decision terminating the Trust Fund to arrangements "similar" to those set forth in the Trust Instrument was to substantive and not to formal similarity. Hence, the application of first credit tranche conditionality as tightened in the past few years would make the new arrangements dissimilar to those of the Trust Instrument, even though they would still be called "first credit tranche" conditionality. An indication of such tightening could be found in the definition of the first tranche of compensatory financing, which had been considered "first credit tranche" conditionality. Such a change would be unacceptable in respect of the Trust Fund resources.

Eligibility could be based, in addition to the level of per capita income, on the existence of protracted balance of payments problems and the need for additional financing on concessional terms, Mr. Hospedales observed. He agreed with Mr. Sengupta that protracted balance of payments problems must be appropriately defined. Absence of alternative sources of finance--or "creditworthiness" in current jargon--was not a proper characteristic for determining access, although it would affect at any time balance of payments need. He did not agree that the so-called blend countries (IDA and IBRD borrowers) should be excluded from access to either tranche of the Trust Fund resources. He welcomed Mr. Sengupta's assurance that his authorities in India would not draw on the facility over the next two to three years. If part of the Trust Fund repayments were reserved for use under Article V, Section 12(f)(ii), emergency cases could appropriately be handled under that provision.

The staff had suggested that the Trust Fund money could be used also to help countries in arrears with the Fund, Mr. Hospedales remarked. However, it was doubtful whether possible programs for such countries related to use of Trust Fund money would often provide a different solution for the problems of such countries than possible programs relating to the use of the Fund's regular resources. In many cases, borrowing from other sources enabling those countries to repay the Fund and restore their eligibility to use the Fund's regular resources would fail to materialize. Borrowers would be reluctant to extend loans for periods sufficiently long to permit the Fund to approve a program, even assuming the possibility of circumventing the practice of not negotiating with a country in arrears so that the period between the re-establishment of eligibility and the approval of the program would be limited essentially to the four-week circulation period required before the Executive Board considered the relevant papers. Of course, the four-week period could also be reduced. The liquidation of arrears must be accorded the highest priority. Another option would be to use Article V, Section 7(g), which provided for the postponement of repurchase obligations "because discharge on the due date would result in exceptional hardship for the member" and of Section 8(e), which permitted the Fund in exceptional circumstances to accept payment of charges in a member's domestic currency.

The proposal to involve the World Bank actively was required because of the importance of supply response policies for development, Mr. Hospedales commented. Thus, close coordination between the Fund and the World Bank could serve the catalytic function of inducing additional finance from private and official lenders--among the latter, the International Development Association and the Special Facility for Sub-Saharan Africa in particular. Of course, a World Bank structural adjustment lending program should not be a condition for access to Trust Fund resources; cross conditionality must be avoided at all costs.

The imaginative proposal of Mr. Dallara raised a number of issues--legal, adminstrative, and technical, Mr. Hospedales concluded. At the present time, his chair could not take a position on that proposal, for obvious reasons, but it would receive due consideration by his authorities. However, it seemed to him that the proposal for a joint World Bank-Fund program, jointly negotiated, represented a significant deviation from the original concept of the Trust Fund. Indeed, the proposal raised other questions; the extent of cross conditionality, the responsibility of the World Bank, as well as the availability of resources from the World Bank. Would there in fact be additional resources?

Mr. Joyce remarked that not many firm conclusions would be drawn from the preliminary discussion of how to use the resources of the Special Disbursement Account but it should be possible to assess which proposals were likely to command the required degree of support. In any event, Ministers would want to express their views at the meeting of the Interim Committee in Seoul.

The starting point of the discussion must be the Executive Board decision of December 19, 1980, Mr. Joyce continued. The other relevant factor was the state of the world economy and particularly the prospects for the poorest developing countries, the intended beneficiaries of the original Trust Fund. The outlook for most of those countries was bleak. Even with an improved external environment, which was far from certain, the prospects for progress were not encouraging. In addition to regular Fund-supported programs, there was clearly a need to do something more for the poorest member countries. The resources of the Special Disbursement Account provided one way of giving those countries additional balance of payments assistance. The question was on what terms and conditions those resources could best be used.

In addressing that question he had been struck by three conclusions in the staff's assessment of the working of the Trust Fund, Mr. Joyce added. First, in most countries, progress toward adjustment had been inadequate. Second, even where there had been improvements, they had often been short lived. Third, for most of the poorer recipients, the resolution of their economic difficulties seemed even further away at present. Not all of that lack of success could be attributed to the modalities of the Trust Fund itself. Economic conditions had deteriorated much more extensively than had been expected--all the more reason for finding the right modalities for the future use of the Trust Fund resources.

He had reached fairly firm views on some points, Mr. Joyce commented, but not on others. He agreed with the staff that the Trust Fund reflows should be consolidated into one new arrangement. The amount of resources involved did not warrant creation or continuation of two separate facilities. The resources should be directed toward those countries most in need of special assistance, countries that faced real limitations on access to other forms of financing. The very low-income countries would be at the heart of that group. Like Mr. Rye and Mr. Jaafar, he believed that the Fund should be careful about depending exclusively on income tests to determine eligibility. There were countries, including some in his constituency, that were clearly poor even though per capita income statistics alone did not reveal the depth and extent of the poverty. As Mr. Mtei had so aptly put it, it was not only per capita income that must be considered but the dire straits in which poor countries often found themselves.

The countries drawing on the resources of the Trust Fund should be those with deep-seated balance of payments problems, Mr. Joyce considered. For that reason, they must also be able to demonstrate a willingness and ability to induce basic policy changes or, in other words, to make structural adjustments that offered prospects for moving closer toward a sustainable payments position. In that sense, the degree of conditionality should be stronger than under the Trust Fund, not with a view to eliminating a high proportion of recipients as feared by Mr. de Maulde but rather to ensure that the funds were used effectively. Compared with regular Fund programs--particularly those carrying only first credit tranche conditionality--the new lending program should be couched in a longer-term perspective and could concentrate on specifics of supply-side measures.

He would be reluctant to proceed with the use of the Trust Fund resources without a formal review process linking disbursements to progress in implementing new policies, Mr. Joyce stated. That process should begin with a letter of intent and first disbursements should be tied to Executive Board approval of an annual program. Subsequent purchases should also be linked to satisfactory program reviews. However, while program targets should be quantified, he would not go so far as to insist on formal performance criteria for those loans, whether or not prolonged use of Fund resources was involved. A program supported by use of resources from the Special Disbursement Account should stand or fall, not upon whether a particular target was met but on whether, in the light of all the circumstances, sufficient progress was being made to justify continued disbursements.

It was quite clear that the World Bank would have an important role to play, Mr. Joyce remarked. The Bank had far better design and monitoring competence in the areas involved than the Fund, which must capitalize on those strengths.

Resources should be additional to whatever might be available from the Fund's ordinary resources to support programs and the terms should be similar to those under the Trust Fund, Mr. Joyce said. As Mr. Dallara had suggested, a distinction also needed to be drawn between eligibility and use. Countries eligible to seek help under the Special Facility might in fact in a given year not need assistance, or need it less than others. Therefore, it would be necessary to determine, probably on a year-by-year basis, which of the eligible countries were likely to be active users of the resources in the immediate future. In that connection, he welcomed Mr. Sengupta's remarks as a most constructive development.

The various question marks in his mind concerned first, eligibility, Mr. Joyce indicated. He was not sure precisely where the line should be drawn: should eligibility be limited to so-called IDA-only countries, and if so, should countries that qualified to use the original Trust Fund be included even if they would no longer qualify at present? Presumably, new members that had joined the Fund since the Trust Fund had been established and that met the income test would qualify. But what about countries that might fall under the income ceiling because their per capita incomes had declined sharply?

Another question was how to treat prolonged users or countries that were currently in arrears to the Fund, Mr. Joyce added. Countries having made prolonged use of the Fund's resources should not necessarily be ruled out; they might have been suffering from weaknesses in external markets or had continuing financial difficulties that might well not be of their own making. It would seem necessary to look at the situation of such countries on a case-by-case basis to determine whether or not a special program would make sense. On arrears, it seemed advisable to distinguish between countries that might have come upon hard times, not entirely by their own fault, and those that might have refused to take necessary adjustment measures. In principle, of course, he accepted Mr. Zecchini's view that the Fund could never tolerate arrears, for any reason. But if a country had worked out a promising, satisfactory adjustment program, the prospect of receiving special Fund assistance if it cleared its arrears might induce other sources of finance to provide the necessary bridge financing. He wondered whether such a possibility should be foreclosed. Rather, the Fund should perhaps consider discussing such problem cases on a contingency basis when it believed that the necessary funds would be forthcoming to eliminate the arrears before the Fund program took effect.

On the question of Fund-Bank relations, obviously the two institutions needed to work more closely together, especially given the nature of the resources involved, Mr. Joyce stated. He did not rule out joint missions. The real issues, however, had been posed by Mr. Dallara. Should the World Bank also be asked to put up resources in every instance? How should the resources of the two institutions be allocated--separately but in parallel, or jointly? Mr. Dallara seemed to favor a unitary approach with not only joint missions but also a single overall program to be approved by the Executive Boards of the two institutions. In his own view, that would probably go too far; the differences in perspective, procedures, and even in the way in which the managements, staffs, and the respective Boards interacted would very quickly become impediments. Thus, he would favor a more cautious, parallel approach but with each institution providing funding under its own program and subject to its own tests. As with the Special Facility for Sub-Saharan Africa, each institution would need to take account of what the other was doing and ensure that their respective plans meshed and were mutually supportive. As for what the Fund would do if the World Bank decided not to provide a structural adjustment loan, again, judgments would have to be made on a case-by-case basis, as indeed they were at present when involvement of the World Bank in conjunction with a Fund-supported program was often vital if a financing gap was to be closed. The existing system in that connection seemed to be working, and he saw no reason why it should not continue to work with respect to use of the Trust Fund resources.

Mr. de Groote commented that he was grateful to Mr. Mtei for having presented his most stimulating remarks in advance of the discussion. He had also been gratified by the open-mindedness of the statement delivered by Mr. Dallara at the previous meeting, which offered a new confirmation of the genuine concern of his authorities for the difficult situation of the poorest developing countries. Mr. Dallara had touched on the two essential issues: In what situations could the resources arising from the termination of the Trust Fund be used to make an essential contribution to relieve members' continuing economic problems? And how should programs supported by the financial resources be designed so as to give the maximum assurance that they would contribute effectively to the adjustment process in those countries? In the views he had expressed on those issues, Mr. Dallara had rightly taken into account the two fundamental changes that had affected the developing world since the establishment of the Trust Fund in 1976, and he agreed with him that the principal concern at present should be how to allow for those changes in the new arrangement that would become effective in 1986. The most positive aspect of the second of those two changes was the gradual awareness of the structural character of the problems of low-income countries. It had been accepted that those problems should be considered in a more appropriate framework, emphasizing the need for a structural reform and substantial World Bank involvement in the adjustment process of those countries.

Four points should be considered by the Interim Committee when it took up the question of the use of the resources to become available from the Special Disbursement Account on the termination of the Trust Fund, Mr. de Groote stated. First, real economic growth in many poor developing countries continued to be inadequate and future growth prospects remained bleak. On developmental grounds, the countries with the lowest per capita income therefore continued to need financial support on concessional terms. However, the resources to be made available should not be spread out over such a large number of countries that their usefulness was dissipated. For the same reason, the two segments of the reconstituted Trust Fund resources should be consolidated. Mr. Sengupta had made a most constructive contribution on the point of eligibility, along the lines of Mr. Dallara's distinction between eligibility in principle and actual use. Of course, Mr. Sengupta was fully justified in wishing to keep the issue of eligibility open in case of a reversal in the situation of individual countries.

The second point for consideration was that the domestic and external problems of many low-income countries had become more intractable because of the lack of financial support from private and official sources, Mr. de Groote continued. Therefore, the Fund would be acting in accordance with its role as a catalyst of financial support if it concentrated the resources available under the new arrangement on those countries that had no access to capital markets and that relied almost exclusively on support from official donors. In that respect, the new arrangement would become a sort of emergency facility for those countries for which programs supported by use of the Fund's ordinary resources could not bring that catalytic role fully into play. By supporting adequate structural adjustment under the new facility, the Fund could encourage other providers of concessional financing to complement disbursements under the new facility.

In that connection, the staff's proposal to extend the new facility to members in arrears to the Fund deserved special consideration, Mr. de Groote noted. The situation of a number of those countries had become hopeless, and it was therefore crucially important for them to be allowed to adopt programs of limited scope, enabling them to obtain financing from other sources and thus become current with the Fund, thereby offering them a chance of making a start on the adjustment process. Far from being excluded from access to Trust Fund resources, those countries should be encouraged to apply for their use, on the presentation of a credible program that would, as it were, break the impasse confronting them by helping them to find resources elsewhere with which to reimburse the Fund. He felt sure that the concern of Mr. Nimatallah over members' arrears to the Fund was shared by everyone. A way to resolve that problem was being opened up, at least for countries proposing a realistic program for structural action to deal with their balance of payments problems. As for countries that were satisfactorily implementing Fund programs, he fully agreed with Mr. Polak that their access to the Trust Fund resources should be automatic.

The third question that the Interim Committee should consider was the need to direct the available resources to the support of programs that placed considerable emphasis on structural adjustment, given the perception that those countries' problems were of a structural character. Another complex and sensitive issue that arose, as the discussion had made clear, was whether the new facility would have its own distinctive role to play in the structural adjustment process, side by side with the operations of the World Bank and, more precisely, side by side with those of IDA, or should the Bank and the Fund move in the direction of fully joint action based on identical policies, as Mr. Dallara had suggested.

As he saw the matter, programs to be supported by the new facility should be designed to help the country correct protracted imbalances in its foreign payments in a medium-term framework, Mr. de Groote continued. In designing those programs, special attention should be given to the structural factors hindering those countries' efforts to carry out successful Fund-supported programs. The elimination of price subsidies, the reorganization of state economic enterprises, privatization of some sectors, and the liberalization of import trade were all measures of a structural nature that had a distinct effect on the balance of payments. World Bank involvement in the preparation, implementation, and financing of the programs should be the normal procedure, as his chair had long argued, but the uniqueness and originality of the programs would reside in their design and the specific balance of payments purposes they would serve. For example, countries that had been prolonged users of Fund resources might see the opportunity offered by a program under the new facility to achieve progress in certain areas that fell outside the scope of regular Fund programs; in doing so, their future chances for success under programs supported by stand-by arrangements might be enhanced.

Given the structural character of the programs, he saw no use--or even feasibility--in linking disbursements to the observance of performance criteria similar to those attached to regular Fund programs, Mr. de Groote added. Because of the time structural adjustment took to show results, the most adequate monitoring method would be assessment of the authorities' commitment to the program and of the progress achieved by means of annual reviews similar to the reviews of structural adjustment loans from IDA. However, he was not sure that he followed Mr. Dallara's argument about quantity and quality; would specific, quantitative targets be assessed in a spirit of understanding or flexibility because of the special circumstances of the beneficiaries? He was not sure that moral or qualitative judgments should be brought to bear. The criteria should be set in specific terms, according to the conditions of the beneficiary country, and the performance assessed in the Fund's traditional way. Rather than change the Fund's style of judging a country's situation, the performance criteria themselves needed to be adapted to the specific aims of the facility being devised to employ Trust Fund resources, taking fully into account the special circumstances of the beneficiaries.

Given the likelihood that adjustment in the countries in question would be gradual, and that they would continue to suffer in the meantime from heavy financing constraints, Mr. de Groote suggested that consideration might be given to more concessional terms for use of the new resources than had prevailed under the Trust Fund. For instance, instead of 10-year loans with a 5 1/2-year grace period, 20-year loans with a 10-year grace period might be provided.

In sum, the situation of the poorest developing countries and their need for structural adjustment supported by external financing on concessional terms was as evident as ever, Mr. de Groote stated. Concentrating the resources derived from the termination of the Trust Fund on the structural problems of those countries would improve the outlook for a more viable situation in the medium term. However, it had become clear from the discussion that even if a single new arrangement was set in place for that purpose--and in that respect he supported the staff proposal--additional financial resources of a concessional nature would have to be mobilized to help countries realize the objectives sought. It would not surprise him if, in the course of setting up programs under the "reborn" Trust Fund, the staff of the Fund and the World Bank came to the conclusion that, even on the terms envisaged, the resources of the Trust Fund would be inadequate to obtain the desired results. The Managing Director might then be led to make it known to the industrial countries interested in the economic recovery of a potential beneficiary that the Trust Fund-supported program could achieve its aims only if additional overseas development assistance was made available. The Managing Director's role might thus become somewhat analogous to the one he had so successfully played for another group of countries. Obviously, the Managing Director's task in that respect would be much lighter if IDA resources were replenished to appropriate levels, and/or if IDA's operations were reorganized in such a way that the contributions of member countries could exert a multiplier effect.

When the Trust Fund had been set up to use part of the Fund's gold holdings in the fight against poverty, Mr. de Groote recalled, it had been mistakenly described by someone as the "distrust" Fund. The truth was that the Fund could be proud of having reconstituted fully that part of the Fund's gold, proving through the repayment of the resources it had made available that its resources were indeed revolving resources, no mean achievement. It should never be forgotten that the Fund had found the best use for that gold.

Mr. Fujino observed that the amount of resources arising out of the reflows to the Trust Fund, which was estimated to be some SDR 2.7 billion, excluding transfers to the Supplementary Financing Facility Subsidy Account, was by no means insignificant. Moreover, one distinct characteristic of those resources was that they could be used to make loans to low-income developing countries on concessional terms since they derived originally from the sale of Fund gold. In examining the ways in which the best use could be made of those valuable resources, it needed to be kept in mind that the primary objective was to help further the balance of payments adjustment of low-income developing countries, as stipulated in the 1980 decision of the Executive Board, while at the same time placing those countries on a sustainable growth path.

The use of those resources must be fully consistent with the temporary and revolving nature of the Fund's finances, Mr. Fujino commented. But he had noted that many low-income countries were suffering from structural weaknesses in the balance of payments and that their progress toward a viable external position might take a somewhat longer period than under programs supported by the use of the Fund's regular resources. In such cases, the use of Trust Fund resources could make a valuable contribution toward better external balance in those countries, if accompanied by the implementation of effective adjustment measures.

In commenting more specifically on the modalities of the new arrangement, Mr. Fujino said that basically he could go along with the staff's suggestion to consolidate into a single new facility the two types of arrangement mentioned in the 1980 decision. The terms of lending, namely, the interest rates and maturity period, could be similar to those on Trust Fund loans.

It would be helpful to review the experience of the Trust Fund in determining the appropriate degree of conditionality under the new facility, Mr. Fujino considered. The minimum standard for Trust Fund loans had been first credit tranche conditionality. Members' programs had not contained any quantified targets and they had not been subject to periodic reviews. According to the staff paper, although a few recipient countries had pursued policies to strengthen their external position, Trust Fund loans had not led to significant adjustment in many countries, particularly in very low-income countries. In order to resolve any structural problems facing their economies, many of those low-income countries needed strong and effective programs of financial and structural adjustment, as well as continued flows of concessional assistance. Those considerations suggested that, at a minimum, the conditionality under the new facility should be strengthened, compared with that for Trust Fund loans. For example, in addition to the requirement that a country be making reasonable efforts to strengthen its balance of payments, the use of some quantified targets might be helpful in monitoring and reviewing progress under the program. They would work as a useful yardstick to review developments and to promote the necessary adjustment. In formulating the adjustment program, coordination at a technical level with the World Bank would be necessary, so that policy advice from the two institutions would be consistent and mutually reinforcing.

As for eligibility, in order to make the most effective use of the resources, he could generally endorse the staff view that the loans should be directed to the countries most in need of concessional assistance, Mr. Fujino stated. Although the amount of available resources was significant, it had to be kept in mind that it was much smaller in real terms than the amount disbursed by the Trust Fund.

The primary criterion for eligibility, Mr. Fujino considered, could be first, per capita income in accordance with the 1980 decision. If the IDA cut-off level were adopted as the first criterion, as for the Trust Fund, the dividing line would be set at a per capita income in 1983 of $790. However, in view of the limited amount of available resources in real terms and the need to focus them on the countries most in need of assistance, the dividing line should be set at a lower income level; the suggestion in the staff paper that those countries should be very low-income countries might be one possibility. Next, in order to qualify as the actual recipient of the loan, the member would be required to show a legitimate balance of payments need and formulate an acceptable economic adjustment program.

With respect to the adoption of some additional criteria, for instance, lack of access to other sources of finance, Mr. Fujino concluded, it seemed necessary to examine carefully the consistency of those criteria with the spirit of the 1980 decision of the Executive Board. He had listened with great interest to the suggestion by Mr. Dallara that countries should present a case of protracted balance of payments difficulties. On the basis of that useful suggestion and its discussion, he expected that a constructive conclusion would be reached in Seoul.

Mr. Alfidja said that he hoped that the discussion of the use of resources arising from the termination of the Trust Fund, preliminary as it was, would help to pave the way for a constructive debate during the meeting of the Interim Committee. He concurred with other Executive Directors in thinking that the proposals made by Mr. Dallara at the previous meeting had important and interesting implications, many of which had not yet been fully elucidated. However, the proposals were worth further explanation, and he intended to bring them to the attention of his authorities.

On the subject of eligibility to use the resources of the Special Disbursement Account, Mr. Alfidja continued, as the staff had indicated, the criterion for consideration should be an agreed level of per capita income as for the Trust Fund Instrument. He also agreed with the staff that a country should have a balance of payments need in order to have access to the resources. Because of the lack of access to international financial markets at the present time of the very-low-income countries, particularly in sub-Saharan Africa, a shortage of development assistance, and the severe financial constraints facing those countries, a way should be found to concentrate the resources of the Trust Fund on those countries. In that respect, he welcomed Mr. Sengupta's statement. Furthermore, he recalled that the Interim Committee had expressed, both in September 1983 and in April 1984, its concern about the special needs of small-quota, low-income countries, recommending the Executive Board to be mindful of the very difficult circumstances of those countries. So far, little action had been taken in that respect. The resources to become available upon the termination of the Trust Fund provided an opportunity to assist those countries. He would have no difficulty with a provision allowing countries in emergency circumstances to gain access to the resources, although he considered that some special criteria ought to be set for the purpose.

On the issue of conditionality, if access to the resources were to be similar to access to the original Trust Fund, conditionality should not go beyond that required for use of the first credit tranche, Mr. Alfidja stated. In his opinion, stricter conditionality would be contrary to the spirit of the Trust Fund. Countries eligible to use the new facility had already undergone adjustment, at a very high social cost, and the time had come to give emphasis to adequate financing of structural adjustment and growth. As his chair had stated on previous occasions, the need for adjustment should not be emphasized at the expense of the social fabric of member countries. He did not share the staff's view that disbursements should be linked--after the first disbursement, upon approval on an annual program--to a monitoring mechanism in the form of reviews.

He was not in favor of merging the two amounts to become available upon the termination of the Trust Fund, Mr. Alfidja stated.

The proposal to involve the World Bank both in the design of the program and in the provision of financing was acceptable to him, Mr. Alfidja stated, provided it did not entail cross conditionality. Eligible members, after submitting an annual program that was acceptable to the Fund, should be allowed to have outright disbursement of the amount allocated to them for the year, without the imposition of prior conditions or performance criteria.

Mr. Zhang observed that he had been attracted by the suggestion that the two available amounts to become available should not be consolidated into a single facility but that the remainder of SDR 1.5 billion--after the provision of balance of payments assistance on concessional terms to low-income developing members--should be made available in the form of grants. The idea deserved further examination.

Eligibility should be based on the criterion of per capita income and not be subject to additional criteria, as it had been under the original Trust Fund, Mr. Zhang commented. For an eligible country to qualify, it should have a persistent and acute balance of payments need at the time the resources became available. Since China was not at present, and did not anticipate being, in that exceptional situation, his authorities would not make any request to use the new facility. The record had shown that China had not competed with other needy developing countries for international concessional financing, and it was not its intention to do so in the near future.

The mechanism under the projected new facility for making the annual disbursement to qualified members was not entirely clear, Mr. Zhang said. How would the annual list of qualified recipients be compiled? On what basis or principle would the actual amount to be received by each recipient be decided?

According to the staff paper, the Trust Fund reflows were intended to be used generally as an "additional resource," Mr. Zhang noted. However, he suspected that the staff might be proposing the application of upper credit tranche conditionality for the use of the resources. For instance, the staff actually advocated the use of performance criteria and reviews, which were normally employed in connection with higher conditionality. It would also be helpful to know whether, if a small low-income country that did not have a program supported by the Fund's regular resources faced balance of payments difficulties and needed Fund assistance, that country could borrow the entire amount for which it might qualify under the new facility, presumably with lower conditionality, without first entering into an arrangement for use of the Fund's regular resources. Presumably, the staff had in mind, in referring to Trust Fund reflows as additional resources, a "cocktail" of resources from the outset. If that was the case, the question was whether the country would have any option but to accept a regular arrangement. Another inevitable consequence would be that Trust Fund reflows could be used only with higher conditionality than under the original Trust Fund Instrument.

In principle, it was a good idea to emphasize structural adjustment and expand the scope for coordination with the World Bank in respect of both program design and the provision of finance to a country that had persistent and acute balance of payments difficulties, Mr. Zhang considered. The existing practice of inviting the World Bank staff to participate in discussions in the Executive Board of the Fund on appropriate occasions was a good start in that direction. As he had indicated in an earlier discussion on the subject, he was rather doubtful about the feasibility and desirability of joint negotiations and Board deliberations. Furthermore, the staff had emphasized correctly that "structural adjustment is likely to take place only gradually." Thus, it would not always be easy at a particular moment to reconcile the objectives of meeting immediate balance of payments needs and long-term structural adjustment requirements. He sympathized with Mr. Mtei when he said that Fund-Bank collaboration should not become another form of conditionality, say, by requiring a country to have a structural adjustment loan from the World Bank in order to qualify for the new Fund facility. It would be desirable for the Executive Board to discuss the broad principles and issues relating to Fund-Bank cooperation again. It might be more appropriate not to derive general guidelines for such cooperation from specific prescriptions intended to deal with a specific situation. In that connection, he asked for information on the content and the size of a typical World Bank structural adjustment loan. In general, how important were such loans in comparison with the amount of resources made available under a Fund arrangement in the overall adjustment program of a country? The answers to those questions were relevant to the decision to be taken on the form and substance of Fund cooperation with the World Bank.

Mr. Nebbia considered that the preliminary discussion of the use of resources of the Special Disbursement Account arising from the termination of the Trust Fund was a very important one, given the huge deterioration of the economic situation of low-income countries and their unfavorable prospects. The use of those resources would contribute to alleviating the most difficult and painful period through which many of the Fund's poorest members were suffering. It was particularly discouraging, as the staff had pointed out, that the latest world economic outlook forecast suggested that the improvement in the situation of the poorest countries was expected to be marginal and, because of the depth of their current problems, would leave them in circumstances that were still extremely difficult. Moreover, the baseline medium-term scenario suggested that in the period remaining until 1990, the growth of imports, exports, and real GDP would all be substantially lower in such countries than in others. Also, there seemed to be little prospect that those countries would return to balance of payments viability and to satisfactory rates of economic growth in the foreseeable future.

Furthermore, the slow growth of imports by the poorest countries in recent years had reflected not only the weak performance of export receipts but also the fact that net inflows of external finance had grown little and in fact had been declining in real terms, Mr. Nebbia continued. The financing constraint was likely to remain severe in the future. While it was necessary to implement structural policies in the economies of those countries, large amounts of concessional external finance would be essential in order to avoid an even more dramatic worsening of their economic situations. As Mr. Mtei had pointed out in his statement, with diminished access to capital markets, declining official inflows, increasing external debt, and no significant growth in exports, low-income countries could not be expected to record much progress all the while the social and political costs associated with adjustment were so high. Moreover, those countries deserved not only the support of donor countries but of international organizations as well. Clearly, the resources to become available from the Special Disbursement Account would be insufficient to improve the economic situation of low-income countries, but they might have a positive catalytic role, attracting additional finance from other sources.

Referring to eligibility to use the resources, Mr. Nebbia said that he supported the use of the resources to help the poorest member countries. Also, he could accept eligibility for IDA resources as being a good criterion for narrowing down the scope of eligibility. The statements by Mr. Sengupta and Mr. Zhang were most helpful. Priority in the use of the resources of the Special Disbursement Account should be given to those countries with the greatest need for concessional assistance and the least access to alternative sources of financing. To introduce the concept of creditworthiness would be dangerous, due to the volatility of the concept in the countries in question. Nevertheless, the Fund should be flexible enough to allow access to countries in emergency circumstances. He joined Mr. Dallara in his view that a country should have a balance of payments, or, more precisely, a protracted balance of payments problem, a term with which he had some difficulty although he could accept it in a loose definition.

The attempt to introduce some kind of performance criteria for the use of Fund resources by low-income countries should be rejected, Mr. Nebbia considered. What those countries needed was a flow of resources on concessional aid terms so that they could implement badly needed structural reforms. Therefore, it was difficult for him to support the linkage between disbursements and the observance of performance criteria. On the other hand, given the limited amount of financial resources available from the Special Disbursement Account, it would be desirable to have financial support from the World Bank.

For the time being, he could not go as far as to accept the proposal for joint programs negotiated by a mixed Fund-Bank team, Mr. Nebbia added. As Mr. Jaafar had observed, that would take away from the Fund's flexibility in designing programs. Although it would be most desirable for a country to have in place a structural adjustment loan, that should not be made a prerequisite, thereby adding to the emergence of cross conditionality. The parallelism mentioned by Mr. Joyce was, in his view, a much better approach.

In the case of members in arrears to the Fund, Mr. Nebbia remarked, the resources available under the new facility could play an important catalytic role. As to whether the two segments of resources to become available should be used separately, or consolidated, his preference would be to disburse SDR 1.2 billion in the form of grants; SDR 1.5 billion could be made available on the same terms as under the Trust Fund. However, if separation of the two amounts were to lead to two different sets of conditionality, his authorities would prefer a single arrangement. Finally, the Fund should play a more active role than in the past in providing concessional aid to its poorest members.

Mr. Pérez said that he welcomed the opportunity to discuss, on a preliminary basis, an important issue that was before the Board as a result of an agreement reached at the previous Interim Committee meeting.

Taking up the main points dealt with in the staff paper, and referring specifically to the broad issues on which the staff had sought the Executive Board's guidance, Mr. Pérez said that his authorities considered that the appropriateness of having one single arrangement would depend in the end on the terms for its use. On the termination of the Trust Fund Instrument, SDR 1.5 billion was to be used under an arrangement similar to that of the Trust Fund, while SDR 1.2 billion was to be used, in accordance with Article V, Section 12(f)(ii), "on special terms to developing members in difficult circumstances," which could be interpreted as allowing more liberal terms for that portion of the resources of the Special Disbursement Account. Therefore, his chair would be more inclined to maintain two types of arrangement if one of them would make resources available on more liberal terms, offering the possibility of providing assistance, as Mr. Mtei had stated, "in a grant form to low-income countries in exceptionally difficult circumstances." Nevertheless, if there was not a consensus in favor of keeping part of the resources for distribution in the form of grants, there would not be much sense in maintaining two types of arrangement, given the amount involved.

He agreed with the idea that the funds arising from the termination of the Trust Fund should be devoted to assisting members in greater need of concessional resources in order to solve their balance of payments difficulties, Mr. Pérez continued. In the view of his authorities, in order to observe that principle, eligibility should be extended to those countries classified as low-income developing countries eligible for IDA financing, with the level of access being made a condition of the magnitude of the country's problems in obtaining financing from the markets or from international multilateral lending institutions. In other words, so-called very-low-income countries that at the same time lacked creditworthiness should be the kind of countries eligible for priority access to the resources of the new facility.

It was clear that the availability of the new concessional resources would afford a good opportunity for those countries benefiting from them to put into effect structural adjustments designed to correct their external position on a medium-term basis, Mr. Pérez noted. Therefore, the economic programs linked to the new facility should be structural in nature with the aim of reducing the trade-off between growth and adjustment to the minimum. In that respect, the additional resources could serve to underpin investment programs, directed in particular to achieving higher growth rates compatible with viable external sectors. That objective certainly would require very special financial conditions as the terms should be similar to those on Trust Fund loans. Given the characteristics of the facility, World Bank involvement appeared to be essential. Nevertheless, like other Directors, he foresaw certain difficulties in having joint Fund-Bank programs. The potential problems might jeopardize some essential characteristics of the mechanism, namely, timeliness and flexibility. The three-year period seemed to be appropriate for implementing the type of program envisaged.

The structural nature of the programs and the need to extend the loans on concessional terms were two factors to be taken into account in establishing the degree of conditionality, Mr. Pérez added. Of the alternatives offered by the staff, his chair was not in favor of applying the system of performance criteria that was utilized for use of the Fund's regular resources, for which he found no justification. Nevertheless, some follow-up of the programs must take place. In that context, annual disbursements should be linked to the fulfillment of conditions similar to those applying to first credit tranche drawings.

The Trust Fund reflows should be considered as additional to other types of resources, Mr. Pérez said. Recognition of that fact might have some important consequences. First, as Mr. Polak and Mr. Grosche had indicated, a country meeting the criteria for traditional programs supported by stand-by arrangements should automatically be understood as meeting the criteria for use of Trust Fund resources. Second, he subscribed to Mr. Mtei's opinion on the so-called prolonged users of Fund resources.

Finally, on the question of arrears, Mr. Pérez said that he shared the view that countries in arrears to the Fund should not be eligible for use of the facility while they remained in arrears. However, the new mechanism would open up important possibilities. Those countries having difficulty in honoring their obligations to the Fund were by definition also faced by serious economic situations and were in most cases implementing strong adjustment programs. If the Fund believed that alternative access to financial resources had already been closed off, despite the efforts of those countries to avoid such difficult situations, then the new facility could play a major role in preventing potential overdue obligations from occurring. Moreover, like Mr. de Maulde, he considered that once a country had solved its arrears problem, it should benefit from the new resources as soon as possible, assuming that it met all the eligibility requirements.

Mr. Finaish considered that eligibility for actual use of the resources to become available from Trust Fund reflows should be limited to the poorest and most needy among the lower-income countries. In accordance with the case made in the staff paper and by other Directors, developing members in difficult circumstances should also be eligible for limited assistance under the new facility.

The type of conditionality to be attached to use of the resources raised difficult issues, Mr. Finaish noted. Basically, he agreed with those Directors who felt that the type of conditionality associated with Trust Fund loans in the past should be retained, as far as that was possible. It was also important that assistance under the proposed arrangement not become a substitute for other sources of finance. He saw

Trust Fund reflows as complementing other facilities of the World Bank and Fund and other bilateral and multilateral concessional flows. Of course, the new ideas and proposals put forward during the discussion would have to be considered more carefully, particularly those mentioned by Mr. Dallara in his statement at the previous meeting.

On the consolidation of the two amounts referred to in the 1980 decision, his position was not yet a firm one, Mr. Finaish remarked. The outcome of the present discussion would influence his thinking on the matter. A split arrangement would be a possibility, if there were good arguments in its favor.

The terms for use of the new resources should be similar to those under the original Trust Fund, Mr. Finaish concluded.

Mr. Salehkhou observed that, despite its very limited resources, the Trust Fund seemed to have served its major purpose adequately. It had provided eligible low-income developing countries with relatively quick disbursing assistance to alleviate the burden of adjusting to the changing conditions of the world economy in the mid-1970s and had compensated somewhat for those countries' limited access to capital markets. The Trust Fund had also enabled the Fund to supplement its regular assistance with resources from a more concessional and flexible facility, directed in particular at the poorest of its members.

It did not seem appropriate to assess the success or failure of the Trust Fund based upon the performance of recipient members in the period following the disbursement of its resources, Mr. Salehkhou said. The assistance received by low-income countries from the Trust Fund had constituted too tiny a proportion of their need for concessional flows to provide significant support for their structural adjustment efforts. At the same time, the actual performance of the economies of those countries during and after the implementation of Trust Fund programs had been adversely affected by a number of unforeseen exogenous factors which, despite serious adjustment efforts, had resulted in a worsening of general economic conditions in most of the poorest countries. Such factors had included in particular the further deterioration in the terms of trade of most of those countries; the impact of the prolonged and severe world economic recession; and the sharp reduction of concessional and noncessional flows induced by both the austerity policies of donor countries and the impact of the international debt situation. In Africa, the impact of those factors had been exacerbated by a prolonged drought.

Notwithstanding the rather unfavorable staff assessment of the outcome of Trust Fund programs--presumably relative to other programs--periodic evaluation of adjustment programs supported by the use of the Fund's ordinary resources with higher conditionality did not prove their superiority, Mr. Salehkhou continued. The so-called success rate of Trust Fund programs with relatively low conditionality seemed to be higher than that of the Fund's regular facilities, although he was fully aware of the problems associated with such assessments.

Although the resolution of the economic difficulties of most of the Trust Fund's recipients seemed even farther away than it had been when the Fund had begun to operate it, the Trust Fund had provided some relief to the poorer developing countries and had helped them initiate or strengthen structural adjustment, Mr. Salehkhou stated. Members in his constituency had called repeatedly for a revival of that type of assistance and for a strengthening of the resources of the Trust Fund. They had also welcomed the Interim Committee's recommendation on the issue, even though it had been limited to the resources that would become available following repayment of Trust Fund loans.

A general problem with the staff report, one that he had at times raised in respect of other staff policy papers, Mr. Salehkhou noted, was that while the report presumed to introduce the main topics for discussion, the analysis was limited to only those recommendations favored by the staff that would closely link assistance under the Special Disbursement Account to assistance from the Fund's regular facilities. Normally, such a staff paper prepared in advance of any consideration of the subject by the Executive Board would be expectd to be more neutral and limited in scope to identifying the issues. If proposals were to be made, various courses of action should be presented and analyzed on each issue, instead of concentrating the presentation on the solution favored by the staff. The point was particularly relevant to the way in which the staff report considered conditionality for the use of the resources of the Special Disbursement Account. The relevant section in the staff paper was concerned merely with how to establish a facility similar to the ordinary use of Fund resources and dealt, in particular, with the modalities for phasing out assistance from the Special Disbursement Account, the general content of programs, the number of reviews, and even possible performance criteria.

The staff's suggestions would represent a radical departure from the nature and the spirit of the assistance provided under the Trust Fund, Mr. Salehkhou added. Without being unconditional, that assistance was meant primarily as an addition to the Fund's regular facilities and as providing quick disbursing relief to the poorer countries of the membership. Therefore, it would be most undesirable to consider the meager resources that would become available from the Special Disbursement Account, to be directed at the poorer member countries of the Fund, as needing to be subject to upper credit tranche conditionality. Equally unwarranted were the suggestions with respect to a possible catalytic role for the Special Disbursement Account and with respect to cooperation with the World Bank on the framework of structural adjustment. Those suggestions clearly would make management of the proposed facility very cumbersome and the negotiations with recipient countries as lengthy and complex as they usually were for use of the Fund's regular facilities. Assistance under the new facility should be quick disbursing and should avoid the conditionality attached to regular Fund facilities. It would also be desirable to give consideration to ways of strengthening the resources of the Special Disbursement Account to make them more meaningful, possibly through contributions or interest-free loans from surplus members of the Fund.

He fully supported Mr. Rye's suggestion to make payments on a grant basis, Mr. Salehkhou concluded. On the method for determining eligibility, he favored the staff proposal limiting the selection of member countries to the truly needy, although one member of his constituency (Morocco) favored a broader definition to cover all members listed in Table 2 of EBS/85/183.

The Director of the Exchange and Trade Relations Department remarked that a further staff paper would have to be prepared in order to pursue some of the issues raised during the discussion on which additional information would be needed, and also to take into account whatever guidance was given by the Interim Committee.

The question of how countries in arrears to the Fund could be brought under the umbrella of the new facility would need to be considered in more detail, the Director added. The staff had had in mind that continued Fund programs, supported by Trust Fund resources, would be of particular value for many countries with extremely difficult arrears problems by catalyzing assistance from other creditors, including official creditors, and not only from the World Bank. It would take a joint effort to mobilize the necessary support in such difficult cases, however, and the new facility might be of particular help in that respect.

It would be critically important to have the response of the World Bank before the proposals for using the resources of the Special Disbursement Account were too far advanced, the Director noted. One especially relevant issue would be the extent to which the World Bank would be ready to provide resources, additional to those they had already planned to make available, for parallel programs or programs supported jointly by use of Trust Fund resources.

In setting up the procedures for access to the new resources, it should be made clear that eligibility for those resources--whether the list was limited to very low-income countries or whether it was somewhat broader--would not preclude access to the Fund's general resources, the Director commented. In fact, it would normally be expected that if the country had a program supported by an arrangement with the Fund in the upper credit tranches, it would qualify for use of the Trust Fund resources.

It was the responsibility of the Fund to prescribe the measures to be taken by low-income countries in arrears and experiencing protracted balance of payments problems, the Director considered. An appropriate exchange rate was often a critical issue in promoting financial balance and economic growth, in part by encouraging capital to stay in the domestic economy. The Executive Board of the Fund was expected to address such issues; it should not be seen as stepping back from its responsibilities by attempting to merge the Fund's policy functions with those of the World Bank. The outcome was likely to be that neither the Fund nor the World Bank would be held accountable.

The recommendation to separate eligibility and actual use was feasible, the Director said. However, if actual use was a matter for separate consideration, and thus left open in case of emergency need, the commitments that the Fund had previously entered into with members would be made less than secure, both in amount and in duration. Therefore, it would be necessary to hold firmly to the proposed two-year or three-year review of the resources available for actual use. In short, although the modalities for using the new resources could be designed to suit the wishes of the Executive Board, there would be trade-offs between the degree to which use of the resources was left open and the lack of assurance for those entering into arrangements with the Fund to make actual use of the resources.

In discussing the relationship between the use of the resources of the Special Disbursement Account to use of the Fund's regular resources, the staff had not had in mind that the Special Disbursement Account facilities would involve different measures to promote adjustment than those for regular arrangements, the Director of the Exchange and Trade Relations Department explained. The idea had been to draw attention to the difference between use of the Fund's ordinary resources and Trust Fund resources in terms of the degree of assurance, given the country's track record, that the policy understandings reached with the member would be effectively carried out; the monetary character of the Fund required particularly careful consideration of that aspect when use of ordinary resources was involved.

The Treasurer remarked that one possible wrong incentive that might be given to countries in arrears with the Fund, if resources of the Special Disbursement Account were disbursed to such countries, was that other members might let arrears build up in order to qualify for disbursements from the Special Disbursement Account. The idea suggested by Mr. Nimatallah of developing a policy program with countries in arrears, in order to protect the Fund's resources and to encourage the member to cooperate with the Fund and thereby improve its economic situation, was desirable in principle but its practical applicability would depend on the exact nature and type of the procedures to be followed. Again, an incentive might be created for the member to prolong such discussions--which would not be negotiations--thereby allowing arrears to increase and presenting the staff with a fait accompli. To take an extreme example, the arrears might escalate, coupled with the need for more rigorous adjustment measures. The Fund's procedures had so far drawn a careful distinction between negotiations on the use of resources by countries in arrears and assistance of a more technical kind in the formulation of adjustment programs, which could be supported by other creditors, thereby enabling the country to clear its arrears to the Fund. The dividing line was a thin but an important one. Nevertheless, the search for more imaginative solutions than had been devised so far to prevent arrears from arising, and to resolve the arrears problems that already existed, should not be abandoned.

Another suggestion had been to use some of the Trust Fund reflows to provide grants, the Treasurer observed. It should be borne in mind that so far the various accounts set up by the Fund to provide grants had all been designed specifically to subsidize the payment of charges to the Fund, and not to provide more general balance of payments support. Any movement in the latter direction would represent a major policy change.

Another factor to bear in mind was that using the Trust Fund resources for grants would obviously mean that those resources would be permanently reduced, the Treasurer added. To that extent, it would no longer be possible to look forward to the productive reuse of the funds in the early 1990s. A more constructive approach might be to protect the revolving character of the resources that, after all, could be made available at a low interest rate, which would make their use more similar to grants, depending on the exact terms agreed. For example, one might compare the five-year SDR interest rate, on which some Fund borrowing was based (and which entered the calculation of the rate of charge paid on borrowed resources) and the terms of the Trust Fund, which had offered a five-year grace period, repayment in five annual installments, and a rate of interest of 1/2 percent. Based on such a comparison, the grant element of Trust Fund loans was close to 60 percent.

Mr. Suraisry explained that the ideas put forward by Mr. Nimatallah with respect to use of the Trust Fund reflows by members in arrears to the Fund had been intended to stimulate reflection and discussion on ways to tackle a problem that it was in the best interest of the Fund and all its members, including those in arrears, to resolve.

The Chairman made the following summing up:

> This preliminary discussion of what are complex and sensitive issues, while it has yielded no firm conclusions, has been extremely helpful to Directors and to the management and staff, and should, in turn, help the Ministers, during the Interim Committee meeting in Seoul, in providing the Board with the necessary guidance to reach its final decisions.
>
> General observations
>
> The background description offered by Mr. Mtei of the plight of the poorest countries which are in dire straits--in Africa in particular, but not only there--was received by the Board with great interest and sympathy. The countries on which the discussion concentrated are indeed experiencing deep-seated structural problems. Under the period covered by the Trust Fund, as many Directors stated, economic conditions and problems had intensified or worsened, and progress toward structural adjustment had been modest. The need for such adjustment is thereby made all the more acute.

Programs supported by resources arising from the termination of the Trust Fund should not be seen as a substitute for concessional development assistance but, on the contrary, should help countries to obtain additional concessional resources.

Specific issues

I will now deal with the specific issues which have been covered by Directors during the discussion.

1. While no firm consensus was reached on specific solutions to the question of eligibility, it is fair to say that the general view was that there was a need, as a matter of practical priority, to direct funds as they become available toward the most needy, very-low-income countries. Formal eligibility would be based on such an income criterion, defined in terms of countries receiving IDA financing, for instance. But in order to qualify for actual use of the facility in any one specific year, the country would have to show what a number of Directors called a protracted balance of payments problem or need. It was thought--and wisely so--that too precise a definition of that concept should not be sought at present; however, an operational definition would have to be found at a later stage. In this connection, I have been heartened, as have Executive Directors, by the most helpful statements concerning the readiness of India and China not to make use of the resources to become available. Several Directors asked for a review of the criteria for eligibility and use after a period of, say, two to three years. I also noted the call by several Executive Directors for some flexibility in the determination of eligibility.

2. On the question of conditionality, all Directors agreed on the need to gear the use of the reflows from the Trust Fund to programs to be negotiated with the interested countries. Views diverged on the degree of conditionality--first credit tranche as opposed to upper credit tranche--and also as to the degree of precision in terms of the objectives of such programs or quantified criteria, if any, relating to their observance. But I was interested to note the strong indication that these programs should have a heavy structural emphasis, and that they should be devised in a medium-term framework.

3. The modalities for monitoring programs have not, of course, been agreed today. Some Directors would like to have a rather precise, quantified monitoring mechanism; others would prefer, for instance, annual disbursements based on agreed annual programs. An interesting aspect of the discussion was that a number of Directors said that they felt we should emphasize the idea of periodic reviews, which would take stock of the way agreed programs and their main objectives were developing and unfolding.

4. On the terms for use of the resources, Directors on the whole favored the maintenance of the Trust Fund terms as far as interest rates are concerned. On the question of maturity, a few Directors mentioned that there was a case, in their view, for some lengthening of the repurchase period, given the worsening of the structural problems that had taken place during the period of the Trust Fund. Some Directors advocated the utilization of at least part of the resources to extend grants, but this was not the majority view.

5. As to whether there should be consolidation of two categories of assets, most Directors, except those who favored, for example, the allocation of grants from one category, expressed a preference for the unification of the two categories, which account at present for SDR 1.2 billion and SDR 1.5 billion, provided of course that a consensus can be reached on the modalities of eligibility and conditionality.

6. There were repeated calls for ever closer Fund-Bank collaboration, given the emphasis on structural and development problems that the countries in question were encountering. In this respect, Mr. Dallara made far-reaching proposals which attracted considerable attention and, to some extent, preliminary support. Those proposals would be taken up, along with other suggestions made, in the light of the preliminary reactions of Executive Directors. The various questions posed by those proposals included legal and technical matters; the issue of additionality, the question of cross conditionality or, on the contrary, the possible advantage of increased complementarity; and, finally, whether the approach suggested by Mr. Dallara would enhance the efficiency of the two organizations or whether it might entail some loss of flexibility and timeliness. All these issues will have to be carefully assessed.

7. A number of questions were asked relating to the operation of the future facility, which will have to be addressed in due course. Among these was the issue of the possible relationship between use of resources of the Special Disbursement Account and

the Fund's regular resources. There was an interesting discussion on a suggestion that these new resources could be used in a way to promote settlement of members' overdue obligations to the Fund.

APPROVED: May 23, 1986

LEO VAN HOUTVEN
Secretary