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## INTERNATIONAL MONETARY FUND

## Minutes of Executive Board Meeting 84/81

3:00 p.m., May 23, 1984

J. de Larosière, Chairman  
W. B. Dale, Deputy Managing Director

Executive Directors

A. Alfidja  
J. de Groot

R. D. Erb  
M. Finaish  
T. Hirao  
J. E. Ismael  
R. K. Joyce  
A. Kafka

G. Lovato

Y. A. Nimatallah  
J. J. Polak  
A. R. G. Prowse

M. A. Senior  
J. Tvedt  
N. Wicks  
Zhang Z.

Alternate Executive Directors

H. G. Schneider  
X. Blandin  
G. E. L. Nguyen, Temporary  
J. Delgadillo, Temporary

T. Yamashita  
Jaafar A.

C. Robalino  
G. Grosche  
N. Coumbis  
A. S. Jayawardena

T. de Vries

O. Kabbaj  
E. I. M. Mtei

A. Lind<sup>2</sup>  
T. A. Clark  
Wang E.

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

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Also Present

Asian Department: C. M. Browne. European Department: J. J. Hauvonen.  
Exchange and Trade Relations Department: C. D. Finch, Director;  
W. A. Beveridge, Deputy Director; S. Mookerjee, Deputy Director; M. Guitian.  
External Relations Department: A. F. Mohammed, Director. Legal Department:  
G. P. Nicoletopoulos, Director; G. F. Rea, Deputy General Counsel;  
Ph. Lachman, S. A. Silard. Middle Eastern Department: A. K. El Selehdar,  
Deputy Director. Treasurer's Department: W. O. Habermeier, Counsellor  
and Treasurer. Western Hemisphere Department: E. Wiesner, Director.  
Personal Assistant to the Managing Director: S. P. Collins. Advisors to  
Executive Directors: A. A. Agah, C. J. Batliwalla, S. E. Conrado,  
S. El-Khourí, S. M. Hassan, H.-S. Lee, W. Moerke, Y. Okubo, I. R. Panday,  
P. Péterfalvy, M. Z. M. Qureshi, D. C. Templeman. Assistants to Executive  
Directors: J. R. N. Almeida, R. L. Bernardo, J. Bulloch, M. B. Chatah,  
Chen J. L. E. J. M. Coene, G. Ercel, I. Fridriksson, G. Gomel,  
V. Govindarajan, D. Hammann, H. Kobayashi, A. Koné, M. J. Kooymans,  
G. W. K. Pickering, M. Rasyid, J. Reddy, A. A. Scholten, A. J. Tregilgas,  
A. Yasseri.

1. PERFORMANCE CRITERIA IN FUND ARRANGEMENTS - REPORTING AND OTHER PROBLEMS - LEGAL AND POLICY ISSUES

The Executive Directors considered a staff paper on legal and policy issues relating to reporting and other problems with performance criteria under stand-by or extended arrangements (EBS/84/94, 4/26/84).

Mr. Tvedt considered that the misreporting of data was a serious problem and that firm guidelines were needed to deal with it. The Fund had been put in the position in 1984 of having to handle payments overdue to it, and the Executive Board had chosen to follow a fairly strict procedure. During the Board's recent discussion of overdue obligations (EBM/84/54 and EBM/84/55, 4/5/84) many Executive Directors, including his chair, had underscored that such incidents could be harmful to the Fund in many respects. For emphasis, he recalled that the Chairman, in his summing up, had said that overdue obligations might well impair the credibility of the Fund if matters were allowed to drift. He would suggest that the reporting problem was of equal seriousness. In order to safeguard the cooperative nature of the Fund, it should be made clear that the institution would have to react firmly to misleading or inaccurate reporting of data.

Referring to Part VI of EBS/84/94, Mr. Tvedt said that he could agree with the procedures set out in paragraph 3, except for the proposal in subparagraph (d) relating to the possible inclusion in arrangements of a clause calling for review and revision of criteria when a program was not proceeding as intended. The adoption of that proposal might create uncertainty about individual members' access to the Fund's resources even though they had met all agreed performance criteria. It seemed undesirable to extend the scope of the Fund's authority beyond the more active application of paragraphs 5 and 11 in the standard texts of stand-by and extended arrangements. In that connection, he joined the many other Directors who had stressed the importance of well-defined performance criteria, and ones for which accurate and timely data were available. Increased technical assistance was a popular remedy, which the Fund should attempt to apply in connection with programs, both at the stage of defining adequate performance criteria or guideposts, and at the follow-up or monitoring stage. He also underlined the importance that he attached to continuous or frequent monitoring of programs in general, much along the lines of some recent and important programs.

As far as the issues raised in paragraph 4 of Part VI were concerned, he was in general agreement with the procedure suggested by the staff in paragraphs 3 to 6 of Part V of EBS/84/94, Mr. Tvedt observed. In other words, he would support the proposal to request an immediate repurchase of a drawing made on the basis of misleading or inaccurate information. Moreover, he would support interrupting the member's right to make further purchases until the repurchase had been made and/or new understandings had been reached with the Fund. Immediate repurchase of an inappropriate drawing would save the Fund the difficult task of determining whether or not the misreporting of data had been accidental or intentional; the same

action would be applicable. Had the data been correctly or appropriately reported in the first instance, purchases would have been interrupted anyway.

He joined Mr. Polak in emphasizing that the expectation of prompt repurchase was not an unknown feature of the Fund's operations, Mr. Tvedt went on. For example, a member was expected to make a prompt repurchase of overcompensation under the compensatory financing facility.

The principle of such prompt repurchase should not, however, preclude the possibility of granting waivers of minor infractions of agreed performance criteria, Mr. Tvedt added, particularly if it was clear that the program was largely or fully on track. It also had to be acknowledged that agreed performance criteria could be less than perfect for a variety of reasons, and they might in certain circumstances call for a flexible approach by the Fund, should problems of formal observation or questions of compliance arise. Nevertheless, in order to avoid to the extent possible situations in which the Fund would have to judge whether or not a member was faithfully cooperating with it, clear guidelines were needed for handling drawings based on faulty data, guidelines that would serve the double purpose of dealing with the problem of misleading reporting and of acting as an effective deterrent. In his view, the procedures suggested by the staff met that requirement.

Issues of "nominal compliance" were particularly difficult, Mr. Tvedt remarked. However, when there was good reason to believe that, despite compliance with the agreed ceilings, action by a member was clearly out of step with the objectives of the program or distorted the aggregates for which ceilings had been agreed, the Managing Director would be fully justified in invoking the provisions described in paragraph 3 of Part IV and referred to again in paragraph 3(c) of Part VI. Should the Fund and a member interpret an agreed arrangement differently, the Executive Board would probably have to handle such cases on an ad hoc basis, as it would be next to impossible to set more precise guidelines for dealing with them. If there were any blame, it could lie with either party.

On the issues raised in paragraph 5 of Part VI, Mr. Tvedt said that, like Mr. Lovato and Mr. Joyce, he did not support the retroactive application of whatever rules or procedures were agreed upon. The staff's suggestion concerning the period of limitation seemed reasonable.

In conclusion, Mr. Tvedt stated, member countries had an obligation to provide accurate and reliable data to the Fund. Any misreporting, whether inadvertent or intentional, must not give the member concerned any advantage over other members.

Mr. Grosche said that he agreed with the thrust of the staff paper, which made it clear that misreporting entailed serious problems not only for the Fund but also for the countries concerned. At stake were the credibility and the cooperative fabric of the institution. The use of Fund resources by members that reported accurately would be impaired by

the inability or unwillingness of other members to do so. Indeed, as the staff and previous speakers had emphasized, countries would be ill advised to provide wrong data, which might hide or even induce wrong policies. The effectiveness of the Fund's policy advice would be seriously undermined if data did not reflect reality. In that context, he thanked the staff for its helpful clarification, in particular on page 5 of EBS/84/94, of the role played by performance criteria as signals for the formulation and adaptation of economic policies.

In order to help members formulate appropriate policies, Mr. Grosche observed, the Fund should continue to monitor closely the application of performance criteria. The prevention of misreporting was preferable to corrective action. First of all, performance criteria could be improved. He fully endorsed the useful proposals made by the staff in that respect. In particular, performance criteria should be clearly defined, easy to measure, and the relevant data should be reported as frequently as necessary. It was certainly advisable to rely on criteria that could be measured on a continuous basis. In his view, the problem of "nominal compliance" also had to be tackled in the context of improving performance criteria. The staff had made some useful points in that respect, but it might have done better not to discuss the problem extensively in a paper dealing primarily with misreporting. He would appreciate the opportunity to return to the issue later and to consider in particular the proposal put forward by the staff in paragraph 3(d) of Part VI.

In order to stress the need to comply with the provisions in Fund arrangements, Mr. Grosche said, he favored the inclusion of a new performance criterion under which purchases would be interrupted if an improper purchase had been made. He could also support the proposal to make active use of the standard consultation provision if there were signs of any emerging reporting problems that might shed legitimate doubts on a member's observance of performance criteria.

The anticipation by members of proper action by the Fund was probably the best means of preventing misreporting and should help to reduce the number of incidences of misreporting, Mr. Grosche considered. Nonetheless, that action should pay due regard to the particular circumstances of the member. In that respect, he fully concurred with the distinction made by the staff in paragraph 4 of the conclusions that when deviations from performance criteria proved to be minor and temporary, the Fund should have recourse to the well-known instruments of a waiver or a modification. However, if revised data revealed deviations of a magnitude that provided clear evidence of a different direction of economic policies than had been envisaged under the program, the Fund would have to respond quickly and flexibly, while still paying due regard to the member's individual circumstances. Like the staff, he would clearly prefer the country concerned to declare its willingness to engage in rapid and corrective measures that could place the program back on track. If, however, strong corrective action by the member did not prove feasible, the Executive Board should call for an immediate termination of its use of Fund resources. The seriousness of such a situation would certainly

warrant an obligation to make any necessary repurchases immediately. In principle, such repurchases should be made in full before the member in question approached the Fund for further arrangements. It should at least be made clear that drawings under a new arrangement should in the first place be used to make the necessary repurchases. Until those repurchases were made, the member's use of the Fund's general resources should be limited.

The final option would be to declare the member ineligible to use the Fund's resources, Mr. Grosche observed. In that connection, he asked the staff whether a limitation on a member's use of the Fund's general resources would apply to drawings under the compensatory financing facility, as he believed it should. He noted that the requirement that the member cooperate with the Fund would be difficult to establish in such a case.

He was somewhat reluctant to consider the retroactive application of any new procedures that might be established for dealing with improper purchases that had already been made, Mr. Grosche remarked. He could go along with the approach suggested by Mr. Wicks in that respect.

Finally, referring to the period of limitation within which procedures could be set in motion to remedy the improper use of Fund resources, he tended to support the staff's view, Mr. Grosche commented. A period of two years would seem sufficiently long to make an effective response possible and to have a deterrent effect on the improper use of Fund resources. But he had an open mind on the point, and suggested that the determination of the period could be made subject to review.

Mr. Prowse said that he had found the staff paper to be useful and convincing, at least theoretically, in suggesting how to deal with the problem of misreporting. However, he had found it less than fully informative on the causes of misreporting, which might affect the balance of any decision that the Executive Board considered taking. Moreover, the legality of the possible remedial measures was not fully clear to him from the paper. On points of terminology, he considered the use of the word "improper" to describe all purchases made without the appropriate statistical data having been reported to be inappropriate. Similarly, the expression "nominal compliance" seemed to be at variance with the concept of compliance: either members complied with quantitative performance criteria or they did not. On the substance of the staff's paper, he had concluded that existing arrangements were broadly adequate to deal with existing problems, although improvement in specific respects was evidently indicated. In particular, the nature of performance criteria called for further attention.

As had already been made clear during the discussion, Mr. Prowse went on, two distinct issues were taken up in EBS/84/94. Although the paper was described as dealing with reporting and other problems on performance criteria, it might have been more useful if it had dealt simply and squarely with reporting problems. The other problems, which he understood

had to do with the formulation of performance criteria, their relevance to actual performance in the real economy and the achievement of program targets, were not tackled in a way that was conducive to arriving at decisions about the formulation of performance criteria. Yet those were all problems that had to be kept continually in mind and that the Executive Board had discussed in other contexts. Indeed, an attempt had been made in EBS/84/94 to recommend solutions to problems that were clearly not related to emerging misreporting problems. For instance, in the much-cited paragraph 3(d) of Part VI, the staff had suggested the possible inclusion in arrangements of a clause calling for review and revision of the criteria when there was evidence that a program was not proceeding as intended. That would scarcely be a question of avoiding misreporting, but rather one of the design of the program or performance criteria, for which the Fund should accept responsibility.

The other problems to which the title of the paper made reference were likely to be far more important than problems arising from misreporting, Mr. Prowse considered. In practice, it was the design of performance criteria, and the program and its real objectives, that would cause the most difficulty. As Mr. Erb had suggested, the criteria were only a guide or a means of measuring performance of the real economy. He could accept that understanding; if it were generally accepted, then the Fund would be giving its performance criteria a significance that they did not and should not have. Would it really be necessary for a member to seek a waiver of a performance criterion, or for the Fund to suspend its right to draw, if all the targets and policy adjustments called for under a program had been met but if a performance criterion, by some quirk, had not been observed? He had been hoping that Executive Directors would make a stronger call than they had so far for flexibility in setting and applying performance criteria.

Referring to the second issue, which he considered to be of less importance to the Fund, Mr. Prowse continued, the staff had made the right start by thoroughly examining the implications of misreporting. As others had said, misreporting could undermine the credibility of Fund-supported programs; what was even more serious, it could mislead policymakers themselves, to the detriment of their economic management.

The incidence of misreporting over the years was not clear from the staff paper, Mr. Prowse observed. The Chairman had fortunately emphasized that the six cases documented were illustrative and not a comprehensive list or definition of the possibilities for misreporting. The staff paper left the impression that there had been many instances of misreporting. It was stated at the beginning of Part VI that "in the recent past, several members have or could have made purchases under stand-by and extended arrangements on the basis of data showing inaccurately that performance criteria had been observed."

In looking for an explanation of why misreporting occurred, Mr. Prowse said, he could share the staff's insight that it might well be due to a misperception of the performance criteria as hurdles to be

overcome to gain access to the Fund's resources rather than as an ex post measure of the extent of the adjustment. The Fund might even be perceived as an auditor rather than as an advisor. None of those misperceptions could be anything but unhelpful, although if they arose, the Fund rather than the members that labored under them was to blame. The Fund needed to emphasize that programs could succeed only if policymakers understood and believed in the potential effectiveness of the program, and if, in committing themselves to it, they had confidence in their ability to carry it out, taking into account the social and political costs. Every effort should be expended to cultivate that confidence and trust in the judgment of the Fund. The suggestion of punishment in the handling of misreporting--even when it was deliberate--would not promote a trusting and fitting relationship between the Fund and its members.

The measures suggested by the staff for preventing the proliferation of cases of misreporting were interesting and deserved more detailed consideration, Mr. Prowse remarked. In paragraph 2 of Part VI, good advice was given, namely, that the solution to the problem in question could not be found in increasingly "intricate and complex performance criteria." The complexity and intricacy of performance criteria might in fact sometimes be the cause of misreporting. He strongly supported the view of other Directors that any "improvements in the formulation and definition of performance criteria," to cite paragraph 3(a), should emphasize simplicity, relevance, and precision. He was not sure whether criteria that could be measured on a continuous basis would be consistent with the need for simplicity. Not many debtor countries would have the capacity to monitor a ceiling that would have to be observed throughout the period preceding the purchase. Members should not be subjected to such complex requirements, especially relating to financial and monetary performance criteria. If the Fund were to ask for more frequent or comprehensive reporting, it would have to bear in mind that various aggregates, such as the money supply and the growth of liquidity in general, could not be assessed meaningfully on a weekly basis. In another context, Mr. Polak had recently suggested that members were being asked for too many data; it was not productive to ask for more frequent and more detailed figures on national accounts and monetary aggregates if the countries could not produce accurate and reliable data.

He could support the use of the existing consultation clause, as suggested in paragraph 3(c), Mr. Prowse commented. For the period immediately ahead, invoking that clause would provide a basis for interrupting purchases, if performance under a program were off target, until new understandings could be reached. The Executive Board was not in a position at the present meeting to take any decisions to make fundamental changes in the Fund's policy on stand-by or extended arrangements.

As he had already mentioned, the problem to which the suggestion in paragraph 3(d) was addressed was not a matter of misreporting but a separate issue of the design of programs and of performance criteria, Mr. Prowse commented. Adequate provision was already made in arrangements for reviews, either every six months or even more often; should there be



any need to revise performance criteria to measure more accurately actual developments under a program, those would be the occasions on which to discuss them with a member.

As for the proposal in paragraph 3(e) for increased frequency of data reporting, it was the quality rather than the quantity of the data that was important, Mr. Prowse considered. A country's scarce resources should be devoted to ensuring that accurate rather than frequent reports were made; the chances of the data being accurate were likely to diminish according to the frequency with which they were provided.

In effect, the thrust of paragraph 3(d) with which he had expressed disagreement was an attempt to bridge the gap between preventive measures and the remedial measures that were handled in a fairly satisfactory way in paragraph 4, Mr. Prowse stated. It would be impractical for the Executive Board to try to distinguish between accidental and deliberate misreporting. Anyone with central banking experience knew that "window dressing" was a fact of life; many countries routinely manipulated central bank statistics for their own purposes, and if they did so in order to meet performance criteria, they could hardly be accused of misreporting. Therefore, he could accept the staff's proposal that the Executive Board should decide, ex post, on a waiver or modification if there were a minor, temporary breach of a performance criterion. Such decisions could be taken on a lapse of time basis. In contrast, the Executive Board would have to meet to discuss nontechnical departures from performance criteria, especially where they were of such a magnitude as to call for policy changes in a program and new understandings between the member and the Fund. Nevertheless, even in those cases, the presumption should not be that the Executive Board would seek repayment of the purchase; it would surely wish to consider, on a case-by-case basis, whether anything constructive would be achieved by requesting a repurchase.

In sum, Mr. Prowse remarked, he could reaffirm the Fund's existing procedures, as long as it was made quite clear that a repurchase would be required if misreporting showed, ex post, that a purchase had been made at a time when either program policies or the criteria would have been modified, had the Fund been in possession of the full facts. Insofar as it was needed, that would have a sufficient deterrent effect. He saw no need for fundamental changes in the Fund's procedures and indeed reiterated his uncertainty on legal grounds with respect to imposing an obligation to repurchase. The provisions of the Articles of Agreement that were cited in Part V, paragraphs 3-6 of the staff paper, did not seem to apply to cases of misreporting. Article V, Section 7(a) did not impose an obligation on members to repurchase; it was permissive. Article V, Section 3(a), and Article XIX, Section 5, were operational provisions of concern to the Treasurer. Of course, the Fund could always in the end invoke Article XXVI, Section 2(a), and declare a member ineligible to use Fund resources if it refused to repurchase under the operational provisions that he had mentioned. Again, he was not sure whether that would be the right course; the real issue was whether the requirement of immediate repurchase would be seen as punitive and

disruptive of the Fund's relationship with a member. Another aspect of that question was whether it would be helpful to expect one government to repurchase because of the actions of a previous government.

Finally, on the period of limitation, Mr. Prowse considered that, if the Fund were to entertain the possibility of requiring members to repurchase, it should restrict the application of the provision to purchases within a period of two years or under a given, current program. Repurchases should not be expected if an arrangement had expired. He took note of the Chairman's statement that, at the present time, no retroactive action was being proposed.

Mr. Nimatallah considered the staff paper useful and timely. In principle, he agreed with the staff that misreporting under Fund arrangements was a potentially serious problem. It was therefore appropriate that the Fund should examine ways to improve reporting and to strengthen its follow-up procedures. However, the problem should be kept in perspective. The vast majority of members with programs under arrangements with the Fund were reporting properly. So far, misreporting had been a relatively rare occurrence; even then, the cause was often technical, the report having been made in good faith, and it could usually be corrected easily without having much effect on the program. The present procedures seemed reasonably adequate as long as a member was cooperating with the Fund. There was no need for excessively complicated performance criteria, which might sometimes be difficult to administer. The Fund should remain flexible and be prepared to give members the benefit of the doubt.

He did however agree with the staff that the Fund could do more to prevent accidental misreporting, Mr. Nimatallah said. In particular, the Fund could be of greater assistance to members by helping them to improve their procedures for recording and monitoring financial data, thus making it easier for them to report to the Fund in a more timely and comprehensive manner.

Fund programs should be based on clear, simple, and precise performance criteria, Mr. Nimatallah continued. If necessary, the criteria could be defined more exactly in a technical memorandum of understanding. For their part, members should keep the Fund fully informed about adjustments and reclassifications in national accounts. In that way, it should be possible to avoid misunderstandings about performance criteria, and to prevent problems of coverage and interpretation.

There was also scope, as the staff had suggested, for the Fund to make more active use of the standard consultation clause in arrangements, Mr. Nimatallah remarked. If reporting problems could be detected at an early stage, they could be more easily corrected.

Taken together, those improvements should help to minimize misreporting that occurred in good faith, Mr. Nimatallah commented. They should also provide a firmer basis for cooperation between the Fund and its members.

Misreporting could be harmful in two respects, Mr. Nimatallah considered. First, when the Fund could identify compliance by a member with the letter but not with the spirit of the arrangement; and second, if the Fund could detect deliberate misreporting. Those two possibilities were worrying because they would weaken the Fund's role in adjustment and undermine the revolving character of the Fund's resources.

If there were clear evidence of fraudulent reporting, Mr. Nimatallah concluded, the Fund should take corrective action. He fully supported the graduated approach outlined in Part V of the staff paper. It was a firm and clear approach that should help to protect the Fund's resources and deter deliberate misreporting. Such a procedure would be in the interests of all members, debtors and creditors alike.

Mr. Mtei stated that the incidents of misreporting cited in the paper under discussion were isolated ones, particularly when account was taken of the type of misreporting that evoked strong objection from Executive Board members. He held the view, in spite of the point made by the Chairman in his introductory statement, that the paper had not covered all misreporting by members. Because of his belief that incidents of misreporting were so rare, he considered, like Mr. Prowse, that there was no need for the Board to adopt any general decision on the issue. Rather than overreacting in that way, he would urge Executive Directors to agree that any problems that might arise could be handled best on a case-by-case basis.

Misreporting resulting from genuine statistical problems should not be confused with misreporting that could be shown to result from a deliberate attempt to conceal or to change information requested by the Fund, particularly in matters relating to Fund-supported programs, Mr. Mtei continued. Such deliberate misreporting should not be condoned by anyone. He certainly did not condone it. The staff should be able, through regular reviews, to detect any deliberate manipulation of data and the resulting misreporting at an early stage, and should bring such cases to the Board promptly. In that respect, he had been somewhat at a loss to understand why the staff had been unable to detect what appeared to have been an obvious problem in at least one of the illustrative cases highlighted in the staff paper. Some Executive Directors had already categorized the misreporting in question as fraudulent. If the staff had knowingly ignored such a problem, which had then come to the attention of the Executive Board after purchases had been made, he would consider that to be a serious matter.

Statistical discrepancies were also a separate problem that should not be lumped together with deliberate misreporting, Mr. Mtei considered. It was well known that the data base in many countries was weak. The proper course of action would seem to be for the Fund to help such countries, where necessary and within the limitations on its ability to do so, to improve the collection and analysis of data. In fact, technical assistance from the Fund in that respect could be of considerable help to many members.

There was something to be said for simplicity and clarity in the formulation of performance criteria, Mr. Mtei remarked. In that connection, he had noted the staff's remark on page 7 of EBS/84/94 that increasingly complex performance criteria would not resolve the misreporting problem; instead, as the staff had noted, such a strategy, "besides impairing the Fund's relations with members, would also alter its role toward that of a permanent auditor dealing with partners unwilling to abide by the accepted code of conduct." However, the proposed changes in the specification of performance criteria did not appear to be consistent with that view. Simplicity would not necessarily be the outcome of performance criteria formulated on a continuous basis or by using averages, as proposed by the staff, particularly in view of the problems of members in collecting data, to which he had already referred.

As for the possibility of including a provision in arrangements to review performance criteria, Mr. Mtei continued, he shared the view already expressed by other Executive Directors that it would create uncertainty on the part of member countries undertaking adjustment programs. Performance criteria were supposed to be objective indicators, agreed with a member country, and assuring the authorities of access to Fund resources on prescribed dates once the criteria were satisfied. Most programs were already subject to review at least once every six months; sometimes two or more reviews were held during a program, even though it might be for only 12 months. That practice had been a useful way of monitoring developments during the life of a program and had provided ample opportunity for taking additional measures if and when necessary. In the circumstances, he saw little to be gained by introducing new rules or more stringent reviews; on the contrary, the objective character of performance criteria was more likely to be undermined. Similarly, to use the standard consultation clause in stand-by and extended arrangements, or to add a new performance criterion to permit the interruption of purchases, as suggested on pages 10 and 11 of EBS/84/94, would give rise to considerable additional uncertainty and seriously erode the assurance that Fund arrangements were supposed to give members seeking financial assistance.

The implication in the staff paper that, even if data showed full compliance with performance criteria, a country might not be allowed to purchase if the staff judged that its compliance was only nominal rather than real, could also seriously undermine members' perception of the reliability of Fund programs, Mr. Mtei considered. The proposal ascribed to the staff the role of final arbiter, even though it was clear that the staff's judgment as to what was real or nominal compliance would at best be normative. That was not to say that value judgments had no role to play in assessing the results of an economic program. The point to be stressed was that in economics and finance, as in other allied disciplines, reasonable individuals might at times reach different conclusions. He needed only to cite the current debate over budget deficits: some of the more advanced countries considered that deficits were not all that important, whereas others saw them as having the potential to forestall sustained economic growth. Even within the staff, problems of interpretation were likely to arise in distinguishing between nominal and real compliance.

Quite possibly, two countries in identical situations handled by different staff members could be treated differently. In his view, that would be inconsistent with the principle of equal treatment.

As much as possible should be done to improve the design and therefore the quality of Fund programs, Mr. Mtei believed, in order to arrive at a better relationship between performance criteria and economic performance in general. As stressed by some Executive Directors, performance criteria were not an end in themselves. What was important was for a member country to attain the economic and financial objectives of a program so that it could ultimately repay the Fund. Performance criteria, as Mr. Erb had put it, should be treated only as guideposts toward the desired economic and financial adjustment objectives. Besides, it was important to note that an obvious reason behind the misreporting of data was the perceived inflexibility of the Fund at a time when members' needs for financial resources to support adjustment efforts were imperative. More flexibility on the side of the Fund, improved program design, and better formulated performance criteria that were pragmatic, simple, and attainable would no doubt help to contain the incidence of misreporting.

Mr. Delgadillo remarked that it was crucial for the success of an adjustment program that the performance criteria relating to the use of economic policy instruments be designed in such a way as to ensure that the observation of the criteria actually produced the desired adjustment. However, difficulties stood in the way both of defining the appropriate limits for the different variables so as to ensure adjustment and of controlling the observance of the performance criteria. In the process of moving the economy toward the established objectives, the use of wrong assumptions might render the criteria inadequate. Many examples could be provided of the need for assumptions that opened up possibilities of mistakes in defining performance criteria. More difficulties of that kind could be expected, the smaller the economy and the less developed its system for compiling, analyzing, and projecting economic information.

Against that background, Mr. Delgadillo continued, a stand-by or extended arrangement assuring a member that it would be able to purchase in accordance with the terms of the arrangement would inevitably involve the risk of some inefficiency in the form of too much or too little adjustment at a certain point in time. A member's observance of clear, predetermined, and objective performance criteria gave it the right to purchase without additional qualifications. Any derogation from the principle that performance criteria had to be fully objective would make it extremely difficult for a member to enter into an arrangement. On the same grounds, the introduction of additional reviews, exposing members to arbitrary interruption in their drawing rights, was to be avoided, as was the notion of nominal compliance. In order to prevent or to solve reporting problems that occurred in connection with stand-by or extended arrangements, he would favor efforts to clarify the objective nature of performance criteria. Along the same lines, he would oppose reliance on reviews or the use of any mechanisms or concepts that might make the member's ability to purchase dependent on judgments or decisions that were beyond its control.

As he saw it, the problem of purchases made on the basis of inaccurate or incomplete information, indicating erroneously that performance criteria had been met, was just another indication of the imperfection of statistical systems or of weaknesses in the administrative apparatus in a member country, unless it could be assumed that the misreporting was intentional, Mr. Delgadillo observed. Leaving aside members that were presumed to have reported in good faith, misreporting problems should be dealt with through efforts to define performance criteria more precisely and to improve the efficiency of mechanisms for generating and analyzing economic information.

If misreporting occurred in spite of every effort, Mr. Delgadillo went on, a reasonable approach would be to interrupt the member's right to make further purchases under the arrangement until the subsequent observance of performance criteria or until understandings were reached between the Fund and the member regarding new measures or performance criteria for the remaining period of the arrangement. If it were not possible to bring the program back on track or to reach appropriate agreements, the Fund should be able to call on the member to accelerate, and to complete in a negotiated period, the repurchase of the amount improperly purchased.

To conclude, Mr. Delgadillo stated, if the Fund were convinced that a member had misreported intentionally, its case should be brought to the Executive Board, which would discuss the sanctions to be applied, including the immediate repurchase of the amount involved and perhaps the immediate cancellation of the program. Depending on the case, more drastic measures could be applied.

Mr. Zhang declared that two facts had to be taken into account in assessing the implications of the staff proposals concerning reporting and other problems relating to performance criteria in Fund arrangements. First, while six well-documented cases of reporting problems were presented in the staff paper, such problems were not common among member countries, nor was there any evidence that they would proliferate in the immediate future. Second, the Fund could in practice undertake a series of comprehensive reviews and apply remedial procedures enabling it to suspend a member's right to make further purchases or even to terminate an arrangement in case of a serious failure to fulfill performance criteria. On the basis of those two facts, the staff's proposals seemed to represent an overreaction to the problem.

In its specific conclusions, the staff had formally distinguished only those cases of purchases based on data showing inaccurately that performance criteria had been observed and those cases based on data indicating a short-lived observance of performance criteria on a particular date, or the so-called nominal compliance, Mr. Zhang noted. However, the staff had in fact treated both categories similarly to cases of improper use of Fund resources because, in its judgment, nominal compliance did not always permit appropriate monitoring of the payment of targets under a program. As a result, the country concerned would be required to adapt

its policies. To accept the staff's interpretation would lead to a basic change in the essential nature of stand-by and extended arrangements, since compliance with performance criteria would no longer assure the availability of Fund resources.

He agreed with the staff, Mr. Zhang continued, that the solution to problems of misreporting did not lie in devising progressively intricate and complex performance criteria. On the contrary, the staff should have examined whether or not the assumptions used in designing the Fund's standard program and its policy content were always appropriate. A Fund-supported program normally attempted to achieve the desired result through the use of very limited sets of tools and by relying upon large movements in the chosen variables. Moreover, Fund programs aimed at realizing real targets by means of financial instruments. There had also been a tendency on the part of the staff to treat performance criteria as if they were ends in themselves.

Specific proposals had been made by the staff for improving existing procedures and for instituting new procedures in order to prevent the emergence and proliferation of cases of misreporting, Mr. Zhang added. First, what improvements were to be made in formulating and defining performance criteria? The improvements should be useful, but the question was whether the changes that the staff had in mind, together with the suggested use of additional memoranda of understanding, would lead to an all-around sharp increase in conditionality under future Fund arrangements.

Second, to rely upon performance criteria that could be measured on a continuous basis, as a means of dealing with the problem of nominal compliance, would subvert the basic concept of Fund stand-by and extended arrangements, Mr. Zhang considered. Besides, experience had shown that, in implementing monetary and fiscal policies, the actual movements of a policy variable could hardly be expected to coincide on a continuous basis with the target.

Third, the proposal to include a new performance criterion that would interrupt purchases upon a determination that an improper purchase had been made was reasonable, Mr. Zhang commented.

Fourth, the review clauses that were normally included in Fund arrangements, and that were used to bring about the adoption of new measures when necessary, had proved quite adequate in practice, Mr. Zhang remarked. The suggestion to introduce a new standard clause calling for review and revision of performance criteria whenever the staff judged it desirable seemed unnecessary and would again subvert the spirit of arrangements.

Fifth, was it really appropriate to increase the frequency of data reporting beyond that normally stipulated in an arrangement, Mr. Zhang asked, particularly in light of the difficulties of borrowing countries in compiling statistics? On the basis of experience, would the more frequent use of resident representatives in that respect really be helpful?

Through the remedial procedures, Mr. Zhang continued, it was appropriate to interrupt purchases and call for immediate repurchases when proper use of Fund resources, based on the deliberate misreporting of data, was proven. Purchases could resume when the performance criteria were subsequently observed or when new understandings were reached. Nevertheless, the procedure for interrupting purchases should not be applied automatically in cases of nominal compliance.

He was not in favor of establishing at the present time rigid rules to prevent or to deal with future cases of misreporting, Mr. Zhang commented. It would be preferable to take a case-by-case approach, the final decision being left to the Executive Board. He agreed with Mr. Kafka that it would not be easy to find a pragmatic solution to the problems under discussion, but when it had been found, it should be incorporated in a formal Board decision.

Mr. de Groote observed that the staff paper was both timely and useful. It had been necessary to give some thought to the problem of misreporting in order to forestall the impairment of the credibility of Fund programs.

He agreed with several Executive Directors on a number of points, Mr. de Groote continued. First, as Mr. Kafka and Mr. Polak had remarked, although it was possible in principle to distinguish between error and fraud, the performance criteria themselves were often defined too narrowly, and their implementation did not always correspond to the objectives of the program. In practice, however, it seemed inappropriate to attempt to pass moral judgments in order to make a distinction between cases of error and those of fraud. If the data indicated nonfulfillment of a performance criterion, and if drawings had been made that would not otherwise have been justified, the outcome should be a requirement to repurchase. Yet repurchase should not be an obligation if the performance criteria could have been better formulated and defined, or if national authorities had observed performance criteria without having met the objectives of the program. In such situations, the Executive Board would have to rely on the judgment of the management and staff in negotiating new performance criteria with the member. Failing agreement in that respect, the issue would have to be brought before the Executive Board for decision. In the last two cases that he had cited, however, he would not favor retroactive application of the requirement for repurchase, because it would throw doubts on the full value of the agreement that the member and the Fund had reached on the conditions of the arrangement.

As he was in favor of a simple repurchase obligation of purchases that were shown to have been made as a result of either error or fraud, Mr. de Groote continued, he was in favor of introducing a special clause in stand-by or extended arrangements, providing for repurchase of drawings made without good cause. In the absence of such a clause, the Fund had indirect means of exercising pressure on the member; for instance, the member might have difficulty obtaining new Fund financing if it did not comply with the repurchase obligation. From a legal viewpoint, and in



order to facilitate the negotiations of arrangements, it would be useful to have a repurchase clause to deal with specific instances of error or fraud.

Furthermore, Mr. de Groote considered, continuous ceilings were appropriate. However, if they were impossible to apply, which was often the case, the staff would have to be vigilant in checking the data at points of time when window dressing was most likely.

More generally, Mr. de Groote observed, the staff paper was, however understandably, directed more at the attitude of members than at that of the staff in that the daily problems of the staff in interpreting performance under an arrangement were not brought out. Yet anyone who had been involved with the discussion of Fund programs could vouch for the need to rely on judgment and interpretation rather than on the pure application of performance criteria. On the whole, the staff deserved admiration for the way in which it dealt with the difficulties that arose daily. The real issue was whether or not the program had been implemented in line with the agreed performance criteria. If the program had been carried out but without the performance criteria having been observed, the criteria themselves were at fault. If the performance criteria had been fulfilled but the objectives of the program had not been met, the staff would have to bring the problem to the attention of management, which in turn would no doubt have to bring the matter before the Executive Board, unless agreement on a new approach could be reached with the member concerned.

On another general point, Mr. de Groote added, it seemed necessary for the Fund to devise performance criteria for inclusion in arrangements supporting programs under which members would make systemic adjustments in their economies. He was purposely avoiding the word "structural" because he was not referring to the type of adjustment that the World Bank should finance. He was thinking of countries that might apply for Fund assistance during a period in which they would undertake to make fundamental changes in their economic systems: reforming state enterprises, relying more heavily on market mechanisms, introducing financial markets, and applying new taxes, such as value-added taxes. The question was whether the Fund could indeed find criteria that could be used to monitor effectively progress under a program of that nature, and whether the Fund could reconcile such performance criteria with its monetary approach to the balance of payments. The effective use of demand management techniques in order to achieve a viable balance of payments position depended greatly in many countries on systemic changes. In his view, it was within the Fund's province to design programs and devise performance criteria that would enable the Fund to monitor progress toward a better and freer-functioning economic system in general in certain member countries, thereby increasing their contribution to world trade.

Both the staff and Executive Directors had handled with wisdom the specific cases of misreporting cited in the staff's paper, Mr. de Groote remarked. It had been generally recognized that, in one case in particular, the Government in question had decided not to draw under its

arrangement with the Fund, as soon as the authorities, rather than the staff, had discovered the problem and subsequently taken appropriate measures to correct the situation that had led to it. The rather interesting question that arose in that respect was what constituted the Government of a country. Was an individual official, who gave the instructions for transfers between the accounts of the central bank and of other state banks responsible for slippages under a program, or were all the Ministers, together with the Prime Minister, or indeed the Head of State, responsible? The distinction had to be drawn in many countries between attempts to "window dress," sometimes for political reasons, and systematic manipulation by the Government of data to cover up slippages.

In conclusion, Mr. de Groote stated, although there was a need to establish rules for dealing with reporting problems that arose in exceptional circumstances, a great deal of judgment and common sense should be brought to bear in considering the proposals in the staff paper. Above all, the Fund should not convey the idea that it was sowing distrust in the field of its relations with members; on the contrary, it should uphold the mutual trust between the institution and the membership. Even if it were considered necessary to devise legal provisions, specifying procedures for dealing with exceptional cases of misreporting, the Fund should continue to pursue its traditional flexible approach, dealing with each problem case by case, and not making any presumptions of misconduct.

Mr. Nguyen noted that the staff paper dealt with a sensitive subject, namely, the credibility of Fund-supported programs, as well as the quality of members' cooperation with the Fund. Needless to say, accurate reporting on performance under stand-by or extended arrangements was of critical importance as a means of surveying the full implementation of the program negotiated with the Fund. The subject had already been tackled comprehensively by others, and it would probably be the subject of further discussion.

The three preliminary points that he wished to make, Mr. Nguyen added, were, first, that different categories of misreporting should not be dealt with on the same level. Much as his chair would agree that the Executive Board should take radical measures when reporting had been fraudulent, an extremely cautious approach should prevail in all other cases. Second, even in the assessment of fraud, the attitude of the staff and subsequently that of the Executive Board should be most prudent, because fraud would be difficult to prove in some cases. Third, the staff and the Board should have a clear understanding of the differing abilities of member countries to comply with their reporting obligations and should take into account the specific problems that some developing countries might face in statistical reporting.

Bearing in mind that those three general ideas would govern the position of his chair in considering how to respond appropriately in particular cases of misreporting in order to prevent the proliferation of misreported information, Mr. Nguyen observed, he had no major difficulties with the measures proposed by the staff in paragraphs 3(a) and 3(b) of

Part VI. It would be particularly helpful if performance criteria could be better tuned to become clearer, simpler, and more precise instruments. His reservation on subparagraph (b), relating to the measurement of performance criteria on a continuous basis, concerned the question of whether or not either the Fund or member countries were well enough equipped, in terms of management and manpower, to monitor such criteria. More generally, the preventive measures proposed by the staff seemed to be well suited to deal with the two cases mentioned by Mr. Polak, and more particularly, with the one in which the tests were met but other broader data did not show satisfying results.

With respect to the measures suggested in subparagraph 3(c) and (d), Mr. Nguyen added, he remained openminded, but considered that a further explanation of those measures, which could be applied only in very specific cases, seemed necessary. The proposal in subparagraph (e) on the increased frequency of data reporting seemed to him to be similar to the suggestion in subparagraph (b) for measuring criteria on a continuous basis. However, if necessary, he could approve the more frequent use of resident representatives, on the condition that there was subsequent reporting to the Executive Board. Finally, he could agree to the procedures envisaged in paragraph 4, which would give the Executive Board the opportunity to examine instances of misreporting on a case-by-case basis.

Mr. Jayawardena said that he was grateful for the Chairman's opening statement that the cases cited in EBS/84/94 were only illustrative of the type of problems that could arise relating to reporting on performance criteria in Fund arrangements, and in no way represented conclusive judgments by the Fund. According to the staff paper, its purpose was to provide a basis for a discussion by the Board of the legal and policy implications of purchases of Fund resources effected on the basis of inaccurate reporting of performance under stand-by or extended arrangements. If his recollection was correct, some Executive Directors had been seeking precisely such a discussion. However, while the staff paper examined a few instances of inaccurate reporting of data, it also examined instances of what it called "technical compliance with the performance criteria" but where the basic program appeared to be off track. Unfortunately, the staff had failed to distinguish between the relative significance or seriousness of the two types of case. He endorsed the views already expressed by several Directors in that respect.

Indeed, Mr. Jayawardena observed, both instances had been lumped together in the introduction to EBS/84/94, as the subject of the staff's serious judgment that they were of concern because "they can impair seriously the credibility of Fund programs," and "...cannot but cast doubts on the seriousness with which members discharge their responsibilities under financial arrangements from the Fund and thus, about the quality of their cooperation with the institution." Those were strong words. Repeated perusal of the staff paper and examination of the cases cited had failed to convince him that that language was warranted. While such a judgment might be appropriate if a member had deliberately sent inaccurate information and data to the Fund with a view to using Fund

resources, he failed to see how such a serious indictment could be made against members in any other of the instances cited. For instance, a country's statistical data might be weak, and hence require revision from time to time when better information became available. Genuine revision of statistics should not open a country to a charge of noncooperation unless it were clearly established that the revision was not in keeping with conventional practice, that it had not been brought to the notice of the Fund, and that no satisfactory explanation had been given of the need for the revision. Clearly, the ultimate solution to the problem of statistical adequacy, as noted in the staff paper, lay in efforts to improve the nature and timeliness of statistics on the one hand, and in the design of appropriate performance criteria, which should be based on more reliable, comprehensive, and timely statistical indicators on the other hand, subject to the proviso that changes in statistical presentation should be made explicit and acceptable to the authorities and the Fund.

The design of both a program and other related performance criteria would also be crucially important in establishing a reasonable congruence between the objectives sought and the policy instruments as measured by performance criteria, Mr. Jayawardena noted. After all, whether a country's program was on or off track was a matter of judgment on which opinions could genuinely differ, either among individuals or between the Fund and the authorities. Generally, a Fund program was structured to achieve a vast array of objectives. It had been abundantly evident in practically all of the innumerable cases that had come before the Executive Board in recent times that countries had been able to achieve some of those objectives but had failed to achieve or had performed less than fully in respect of other objectives. It would be problematic to impose sanctions on countries based on the highly subjective and difficult judgments that would have to be reached, as had been proposed in the staff paper. Normally, when a Fund program was basically off track, the country would not be in a position to fulfill the performance criteria if those criteria had been adequately formulated. There might be many good reasons for formulating the performance criteria in a given manner. Typically, criteria were tailored to the special circumstances of each country. Therefore, the necessary congruence between the program and the criteria should obviously emanate from a deep understanding of the conditions in the country and of the logistic feasibility of implementing a particular program.

Hence, it was extremely difficult to generalize definitions of performance criteria, Mr. Jayawardena remarked. Each mistake was an opportunity to learn; with greater experience and knowledge, performance criteria were bound to improve constantly, as they should, without the need to make them unnecessarily intricate and complex, so that they became difficult for the Fund as well as for member countries to satisfy and/or to monitor. However comprehensive the performance criteria might be, a country could contrive to appear to fulfill them without achieving most of the objectives of the program, as pointed out in the staff paper. The diversity of accounting conventions and methods of statistical presentation might mean that such possibilities of "misreporting" would always

exist. If so, the solution to the problem might well lie in the establishment of mutual trust and cooperation between countries and the Fund, and in an understanding that changes in statistical presentation would require consultation and maybe agreement between the authorities and the Fund. It did not befit the Fund to play a punitive role: there had to be mutual confidence between it and member countries so that problems, differences of opinion, and policy options could be freely and candidly discussed, and understandings reached. Without that cooperation and trust, Fund programs were seldom likely to succeed.

For those reasons, Mr. Jayawardena went on, imposing sanctions on member countries for so-called improper use of Fund resources, as mentioned in the staff paper, would be unwarranted, except in clear and unambiguous instances of deliberate misrepresentations by a member of its actual situation. Such misrepresentations would occur only very rarely because of the difficulty of concealing them for long and because the implications for the honor and integrity of the country were so serious. Acceptance by the international community of a country's integrity was of such critical importance that its loss was the supreme penalty for, and the most severe deterrent to, misrepresentation. That penalty could not be bettered by any sanctions or deterrents that the Fund might decide to apply, and it moreover explained the virtual nonexistence or rarity of deliberate misrepresentation.

The magnitude of the reporting problems encountered by the Fund was not clear from the staff paper, Mr. Jayawardena commented. At the outset, the staff had referred to a "number of instances" having arisen, going on to note "relatively isolated instances" that raised issues of concern. As far as could be known, the instances did not appear to be widespread; some of the cases described in EBS/84/94 might not have been cited at all, had all the facts and the circumstances been taken into account. As it was not the proper occasion to discuss individual cases, he had taken up that matter bilaterally with the staff. His point was that it might not be advisable to overreact to a few individual cases of misreporting by trying to lay down new policies or change present policies. Highlighting the rare instances could be counterproductive by casting doubt on the credibility of the quality and effectiveness of Fund programs, and might also affect the general image of the Fund and of individual members. It was therefore necessary to approach the fundamental issue with great circumspection.

He did not condone deliberate misreporting, Mr. Jayawardena remarked; nor would he suggest that corrective action should not be taken, if there were large deviations from originally furnished data. To maintain its integrity, the Fund had to take action to remedy such problems. However, laying down rigid rules or criteria to be applied to all members across the board in respect of all programs would be inadvisable. On page 18 of EBS/84/94, the staff itself had correctly observed: "...a solution to the problems addressed here does not lie in devising progressively [more] intricate and complex performance criteria." Ultimately, everything would depend on the manner of cooperation between the member and the Fund in carrying out their obligations and responsibilities.

Referring to the more specific issues raised in the staff paper, and subject to his preceding general comments, Mr. Jayawardena stated that he had no objection to an improvement in the staff's analysis and formulation of performance criteria. The outcome should not however lead to unnecessarily intricate rules, because the existing criteria were already difficult enough to monitor and implement. Greater complexity would compound the problem and might make Fund programs unworkable.

He was opposed to the suggestion of continuous measurement of criteria instead of measurement at a given point, Mr. Jayawardena added. Authorities had difficulties in providing data even under the present system. To provide data on a continuous basis might be well-nigh impossible. Many countries, especially developing countries, did not have a data base or the technical expertise to provide information on a continuous basis. Moreover, continuous monitoring would require careful anticipation of seasonal factors: a chance event such as the delay of monsoonal rains could interrupt a program, whereas monitoring over a longer period would give a country the opportunity to bring its program back on track. Furthermore, to include a provision for continuous measurement of criteria could lead to frequent interruptions in programs owing to lack of data.

He could also not agree to the inclusion in arrangements of a new performance criterion calling for the interruption of purchases whenever it was determined that a purchase under the current or any previous arrangement for which the period of limitation had not yet ended had been made despite a lack of observance of performance criteria, Mr. Jayawardena said. First, great uncertainties would be introduced into countries' economic management. Second, arrangements were entered into only after detailed discussions, and performance criteria were devised only after mutual consultation and agreement between the member and the Fund. The letter of intent was generally signed by a Minister and the Governor of the Central Bank. Derogation from such an arrangement would be improper, except for the most compelling reasons, and, even then, only after appropriate consultation. It would be better to bring the matter to the notice of the authorities and then to the Executive Board for a full discussion and determination of the action to be taken.

The staff's proposal to include a clause in arrangements calling for review and revision of the criteria when there was evidence that their observance did not necessarily indicate that the program was proceeding as intended could also introduce much uncertainty into Fund programs, Mr. Jayawardena considered. Economic management plans might even be disrupted, and the sanctity of the agreement between the authorities and the Fund violated. The ability of the Fund to devise programs might even be thrown into question, especially if the member had observed the criteria as agreed, and if the Fund later came to the conclusion that program objectives were not being achieved. Besides, there were review clauses in almost all arrangements--sometimes calling for two or three reviews in a year--and the Fund could take advantage of them to update and revise the criteria. However, it should not be forgotten that too many reviews could in fact inhibit the progress of the program.

Another suggestion by the staff was that the frequency of data reporting should be increased in order to enable irregularities to be detected early, Mr. Jayawardena commented. The suggestion might not pose any problem if the data were collected routinely by the authorities, but if the data had to be compiled specifically for the program, many countries might not be in a position to provide them more often. The presence of a Fund resident representative in the countries would not improve matters; the Executive Board should maintain its current policy of not proliferating resident representatives.

Where the deviations in data reporting were minor and temporary, ex post waivers could be granted, as the staff had suggested, Mr. Jayawardena continued. With respect to large deviations between original and subsequent data, the staff had suggested possible action by the Executive Board, such as requests for repurchase, for the sale of a member's currency, or, as a last resort, for a limit on the member's right to use Fund resources, even a declaration of its ineligibility to do so. It would certainly be appropriate for any such cases to be brought before the Executive Board for action along one or another of those lines, depending on the gravity of the case. He was inclined to agree with those Directors who felt that sanctions limiting members' rights and declarations of ineligibility were drastic measures and were likely to be counterproductive. Basically, no rigid rules need be prescribed, even in more serious cases of misreporting.

The question had been raised in the staff paper whether the type of action being considered to deal with misreporting relating to a purchase that had already been made should be applied retroactively, Mr. Jayawardena remarked. Retroactive legislation was typically fraught with difficulties and was universally seen to be unfair; he would certainly not support retroactive action by the Fund. However, he would agree that, in future, a member that had made a purchase based on data that were subsequently proved to be incomplete and inaccurate was honor bound to make an early repurchase, as for overcompensation under the compensatory financing facility. Nevertheless, a distinction should be made between a genuine revision of data arising from inadequate statistical services and a clearly deliberate attempt to misrepresent facts. In the former case, the Board should exercise its judgment, based on the explanation provided by the member, and it should continue as in the past to give the member any benefit of the doubt.

In doing so, Mr. Jayawardena said, the Executive Directors should also be mindful of four factors: First, the statistical information necessary for monitoring programs generally became available in most developing countries with a pronounced time lag, so that corrective action could be taken only with a similar lag. Second, an early repurchase could cause difficulties for the member. Third, efforts that a member might have made to rectify the lapse should be taken into account, for instance, the adoption of further policy measures and any improvements effected in its statistical system. Fourth, note should be taken of further refinements of performance criteria that the staff might be contemplating. As for the second category of deliberate misreporting, clear provision should be made for early repurchase, and adequate sanctions applied if the repurchase were not made as requested.

In sum, Mr. Jayawardena restated his belief that cases of deliberate misrepresentation were neither widespread nor extensive, and that there were no serious lacunae in performance criteria that would enable countries to engage flagrantly in what was termed "improper use of Fund resources." The few cases of misreporting that might occur could be dealt with under present provisions: where deviations were minor, by granting a waiver, approved on a lapse-of-time basis; and where they were major, by bringing the issue before the Executive Board. Open, candid, constructive, and frequent dialogues with countries would go a long way toward establishing mutual trust and cooperation, which was the only practical solution to the problems under discussion. The greatest deterrent to misrepresentation was the loss of confidence and acceptance by the international community; no deterrent that the Fund could devise would be more effective. In fact, the present discussion and the likelihood of future examinations by the Executive Board of deviations in the provision of data were also strong deterrents to misrepresentation. Thus, the Fund should desist from adopting criteria that were so complex that programs would become impossible to monitor. In fact, the staff paper clearly stated that the Fund had adequate authority to take effective action against the misuse of Fund resources. Therefore, there was no need for additional rules, which would reduce the effectiveness of Fund programs, and damage the image of the Fund as an institution based on international cooperation. However, if it were the wish of the Executive Board to draw up rules to meet certain extreme instances of misreporting, he would endorse the view expressed by Mr. Kafka and Mr. Polak that a clear-cut decision should be adopted so as to leave no room for any ambiguity of interpretation. Any such decision would have to be taken after a full discussion of proposals by the staff.

Mr. Hirao remarked that it was a source of concern to him that the type of problems presented in the staff paper had arisen recently. As the staff had noted, such problems could impair the credibility of Fund programs at a time when maintaining and enhancing their credibility was of the utmost importance. He could agree with the staff that misreported information undermined the policymaking process and decreased the likelihood of members' attaining their objectives; both developments would be detrimental to the adjustment efforts of the countries concerned. Trust between the Fund and its members might also be eroded. The staff was right to maintain that the solution lay, not in devising intricate and complex criteria, but rather in the member's willingness to behave responsibly. Appropriate ways to handle the type of problems described in EBS/84/94 should be explored, the aim being to strengthen trust between members and the Fund.

In order to prevent any proliferation of instances of misreporting, Mr. Hirao continued, it would seem best to increase the contact between the Fund staff and the member, thereby increasing the frequency of data reporting. Active use of Article IV consultations and of review missions, as well as more frequent provision of technical assistance, would certainly be helpful. The staff had already been making efforts in that respect, which had contributed to preventing an exacerbation of the problem.



In addition to greater frequency of contact, Mr. Hirao remarked, some of the specific suggestions made in the staff paper for improving existing procedures should be given further thought. The most important of those various suggestions concerned improvements in the formulation and definition of performance criteria, in order in particular to increase their clarity, simplicity, and precision.

The inclusion of a clause in arrangements calling for the review and revision of criteria when there was doubt about the effectiveness of those criteria as monitors of progress might be helpful in some instances, Mr. Hirao considered. Of course, as other Directors had mentioned, the wide variety of possible cases of misreporting would impose a need for caution and judgment. It should also be kept in mind that such a procedure could not be a substitute for efforts to define simple, objective, and effective performance criteria at the outset of the program. The revision of criteria would be justified only when the need for it was obvious.

When legitimate doubts about the observance of performance criteria arose, it would be useful to activate the standard consultation provision in arrangements, Mr. Hirao noted. In that way, it would be easier to resolve difficulties at an early stage. He could support the inclusion in arrangements of a new performance criterion that would interrupt purchases, if it were determined after careful review that improper purchases had been made warranting such interruption.

Whenever instances of misreporting of data occurred, the Executive Board would have to be fully informed and would have to take appropriate action, in view of the relevant factors, in order to protect the cooperative character of the Fund, Mr. Hirao said. A waiver or modification of performance criteria might be justified in some cases, whereas, in certain other cases, decisive corrective action would be required. Appropriate responses by the Executive Board would differ from one case to another, as full account was taken of the factors specific to individual cases. As for purchases that had already been made on the basis of misreported data, it would be appropriate, if the Board so decided after careful consideration, to request the member to make a prompt repurchase. It would be preferable for the member to respond to such a request as a matter of moral responsibility.

Finally, the period of limitation should be long enough to ensure that the Fund could make an effective response to improper use, Mr. Hirao considered. Taking practical considerations into account, he could support the suggestion to allow such a response to be made within two years from the date of purchase or over the period of the arrangement, whichever was longer.

Mr. Kabbaj stated that the issues raised in EBS/84/94 were sufficiently important to warrant a clear definition of the problem. There had indeed been isolated instances--which had been explained in detail in the form of case studies--where drawings had been effected on the basis

of observance by a borrowing member of the performance criteria but where upon later examination the data reported originally had been shown to be either inaccurate or incomplete. A further examination of the nature of such reporting problems revealed that they ranged from overstating target variables, such as foreign exchange reserves, to inaccurate reporting of data on credit and other ceilings, thereby affecting performance criteria. Such deviations naturally affected the stance of the corrective policies that were implemented by the authorities in the borrowing countries.

Other problems related to the poor quality of the reported data, Mr. Kabbaj continued. Reporting systems needed to be constantly improved and updated. How the task was undertaken obviously varied from one country to another, depending on the particular institutional arrangements. The Fund could help to alleviate the problem by offering its technical services. But apart from statistical shortcomings and difficulties in the compilation of data, the scope of data coverage and classification might differ, thereby making the complete standardization of data definitions difficult. Nevertheless, such problems were not major bottlenecks because the experience gained by successive missions enabled the staff to acquire a deeper understanding of the ways in which deviations from standard definitional concepts had occurred. Thus, it should be easier to foresee and to correct such variances well in advance. Moreover, genuine data revisions could reveal major changes, based on subsequent information unavailable when the data had first been reported. Revisions of that type were prevalent, and were not peculiar to developing countries; they occurred irrespective of national or geographical considerations.

Among the more substantive problems that had arisen, as outlined in the six case studies, Mr. Kabbaj went on, some member countries had not requested the purchases that were contingent upon the fulfillment of a particular criterion after its reclassification or after certain inaccuracies had been revealed. In still others, the reclassification of the economic variable in question had subsequently been accepted by the staff because provisions for that eventuality had not been made in the arrangement. There had also been instances of insufficiently comprehensive definition of performance criteria, enabling technical loopholes to appear, which had later been acknowledged and closed.

It was important to note that in most of the cases cited, remedial action had been taken to correct faulty reporting, to reclassify data, or to remedy other possible nonconformities. Otherwise, members had refrained from making additional purchases where it had been determined that there were inconsistencies in meeting the performance criteria. It was equally important to note that the subsequent nonobservance of such criteria had in most cases been limited to a single criterion, with all other aspects of the programs having remained wholly on track and other performance criteria having been scrupulously met.

In discussing preventive or remedial measures, Mr. Kabbaj observed, a case should first be made that the problems encountered were broad enough and occurring with sufficient frequency to justify laying down

more new regulations and preventive procedures. His chair believed that so far the available evidence did not support such action. Cases of misreporting were isolated and, as such, should be dealt with ad hoc. The design of programs and the general rules currently in effect were sufficiently flexible to enable the Fund to exercise broad judgments about performance under a program. While intentional misuse of Fund resources should be prevented, there had as yet been no clear case in which the evidence of impropriety or bad faith on the part of the authorities had been overwhelming. In fact, the staff had acknowledged on page 8 of its paper that it was difficult to identify purchases based on deliberately misreported data. It therefore followed that elements of judgment had to be introduced in differentiating between nominal and real observance of performance criteria, between significant and modest digressions, and in determining the underlying reasons for noncompliance with the program criteria. The exercise of such judgment by the Fund was bound to raise serious legal issues pertaining to members' sovereignty and the extent of the Fund's jurisdiction. Subtle differences between similar cases, arbitrary decisions, and the difficulty of making strict comparisons between seemingly similar cases of noncompliance would significantly complicate that task.

There was thus no merit in probing deeply into isolated cases, or in laying down more rules and procedures in anticipation of unsubstantiated wrongdoings, which could be righted by ad hoc and flexible treatment of the sort currently in effect under the broad provisions of adjustment programs, Mr. Kabbaj considered. While problems of the type that he had mentioned might adversely affect the successful attainment of program objectives, thereby casting doubt on the adequacy of the Fund's adjustment programs, and might lead to a misuse of Fund resources, all the available evidence suggested that those problems could be tackled bilaterally between the borrowing member and the Fund. More serious cases could be handled by the Executive Board.

Referring to the preventive measures outlined in the paper, Mr. Kabbaj considered that improvements in the procedures for collecting timely data should be made with greater speed and intensity. Article IV consultation missions and other staff visits would be good occasions for promoting and encouraging more accurate data reporting. In addition, more frequent and intensive training of the personnel of central banks or ministries of finance, and an expansion of the activities of the IMF Institute, should be considered. The scope of the data reporting problem indicated a need for greater technical training programs in the Fund.

He was also in favor of more accurately defining performance criteria in order to prevent ambiguities and misunderstandings, Mr. Kabbaj remarked. The staff should be sufficiently familiar with the nature of those ambiguities to be able to clarify in advance the coverage and scope of the program targets. Such clarifications could obviously encompass the consultation requirement when the reclassification of data was likely to affect significantly the outcome of those targets.

As for the scope of the consultation clause and the possibility of interrupting purchases, Mr. Kabbaj considered, paragraph 11 of the standard format of stand-by and extended arrangements was sufficiently comprehensive and gave the Fund broad enough discretionary power to call for additional consultations whenever extraordinary events made that desirable. Paragraph 11, together with paragraph 5, should continue to provide safeguards in exceptional cases. In fact, the interpretation by the staff of those provisions was so broad that it would eventually give the Fund the power to deal with exceptional cases. Therefore, he saw no pressing need to include a new performance clause to interrupt drawings subsequent to a purchase that, new evidence suggested, had been made despite the nonobservance of a target. Such an approach would introduce great rigidity into programs. For the same reason, he could not support the inclusion of additional reviews in the form of still more new performance criteria.

As mentioned in the staff paper, Mr. Kabbaj commented, additional rigidities would undermine the objective character of performance criteria and would lessen the certainty on which borrowing members counted in approaching the Fund to use its resources. The likelihood of arbitrary interruptions of members' drawing rights would be equally unacceptable.

In discussing remedial procedures, it was necessary to be cognizant of the difficulty of ascertaining the precise source of noncompliance, Mr. Kabbaj said. Nevertheless, it seemed to him that the existing provisions, especially the various sections of Article V, were sufficiently comprehensive to deal with potential misuse of Fund resources. Thus, no new procedures seemed necessary at the present time.

With respect to the nominal fulfillment of performance criteria and the digression of a program from its predicted path, Mr. Kabbaj remarked, he remained unconvinced by the argumentation in the staff paper. In addition to the arguments advanced by Executive Directors, he would caution against stretching the interpretation of Article IV along the lines mentioned on page 13 of EBS/84/94. Should an adjustment program remain off track, despite scrupulous observance of all performance criteria by the member, the problems might be multifaceted and too complicated for the Fund to be able to place the onus of responsibility squarely on the shoulders of the member country.

Although the timeframe for correcting deliberate deviations should be limited, so as to reduce uncertainty, Mr. Kabbaj concluded, his chair believed that it would be more appropriate for the Fund, as in dealing with other similar problems, to exercise flexibility and discretion than to stipulate specific limitations on the period. Indeed, the diversity of circumstances would preclude laying down rules and procedures, additional to those currently in operation, in the most serious case of a *prima facie* breach of good faith.

The Director of the Exchange and Trade Relations Department said that he welcomed the almost universal agreement in the Executive Board with the idea that the staff itself had conveyed in its paper, namely, that the only real solution to the problem of misreporting was to strengthen cooperation between the member and the Fund. The staff had not intended to look for a solution based on making performance criteria more complex, or on using resident representatives as inspectors. Rather, the objective had been to find ways to increase and strengthen the normal cooperative working relationship between the authorities and the Fund staff.

In treating nominal compliance alongside instances of straight misreporting, the Director continued, the staff had wished primarily to draw attention to the common interest of members and the Fund in effective compliance. There had been no desire to attach the same importance to both categories. In general, however, all members wanted to be able to draw, and if pressure were brought to bear on those responsible for reporting data to vary the presentation or classification of figures, the common interest of the member and of the Fund in the establishment of efficient procedures based on trust would be at stake. In that context, the staff had felt that certain "window-dressing" arrangements were not dissimilar in their effects to straight misreporting. It had therefore been considered advisable to bring the entire matter before the Executive Board. Certainly, it was as incumbent on the staff to inform the Executive Board correctly as it was on the authorities to provide the staff with correct information. Confidence in the data reported was essential to protect the relationship between the member, the staff, and the Board.

The potential similarity in the impact of the two types of misreporting did not however extend to the legal position, according to which, as long as there was compliance with the performance criteria, the arrangement would not be affected, the Director continued. The question of penalties or of the need to repurchase would arise only if, on the basis of data provided to the staff, there had been noncompliance with the performance criteria, as they had been understood and approved by the Executive Board. The review that had been suggested if there were nominal compliance would not be the same as the traditional midterm review. The idea had been to find a way, if the figures indicated only nominal compliance with the criteria, to bring the matter to the notice of the Executive Board, which would then reach a judgment whether or not there had been a major new and unexpected departure from the implementation of the agreed policies. It was not strictly a matter of meeting the specific criteria relating to, say, the balance of payments or the fiscal performance.

It had obviously not only been difficult to express those ideas in the staff paper; it was even more difficult to try to encompass in a simple performance criterion, and in legal form, a means of defining nominal compliance, the Director remarked. The general desire that had been expressed to stress cooperation argued against pressing the issue further. In general, when the staff raised issues of compliance with performance criteria with a member, and the authorities recognized that a

change in reporting procedure had been inappropriate and had an effect on the member's right to draw, it was to be expected that they would be willing to let the staff take it into account and bring it to the Executive Board's attention. The staff would be happy to continue that approach, but it had nevertheless wanted to bring to the attention of the Board the possibility of problems that could not be fully resolved unless the arrangement contained an explicit review clause to deal with cases where there were doubts about compliance with an agreed feature of an arrangement. The objective was to have performance criteria as objective and straightforward as possible, and Executive Directors had rejected, probably rightly, the notion of an additional review clause.

The reason why the staff had felt the need for more than a case-by-case approach, or a simple attempt to improve procedures, to deal with instances of misreporting, the Director explained, was that a few countries had been allowed to make drawings that the staff had found later should not have been made because the terms of the arrangement had not been met. If necessary, the staff could make a more precise presentation of the exact provisions that would be required to deal with such instances. In that context, it was essential to treat members uniformly. A member that had complied meticulously with the terms of an arrangement should not have to wait to draw because a standard review clause had been introduced to deal with incorrect reporting, whether by carelessness or by intent. But uniform treatment did not mean that selective judgments could not be made in cases of misreporting to release funds under an arrangement, if the deviation were minor and temporary.

It was certainly not for the staff to judge whether misreporting was erroneous or fraudulent, the Director added. The staff was concerned with the facts, not with the origin of the problem.

In suggesting that consideration be given to continuous reporting, the Director of the Exchange and Trade Relations Department explained, the staff had been conscious that the more a member knew about developments in its economy, the less chance there was of its encountering a sudden problem. There were occasions when, without warning, the figures revealed that a ceiling had been breached, or when there were pressures to adjust the figures to meet a ceiling, and continuous monitoring would make those occasions less likely to arise. The current practice in cases where a continuous ceiling had been exceeded was that a drawing could be subsequently made when observance of the ceiling was resumed. The staff had envisaged continuous ceilings as a means of improving cooperation with a member and of enhancing the staff's understanding of a member's problems. It was in that context also that thought had been given to making greater use of resident representatives, who had always been regarded as advisors, ready at all times to help a member, and not in any way as inspectors. In sum, the only successful way in which the Fund could work was to raise the level of cooperation with members, making sure that it was solidly based.

The Director of the Legal Department observed that as several Executive Directors had mentioned, in accordance with Article XXX(b), a stand-by arrangement by definition assured a member that it would "be able to make purchases from the General Resources Account in accordance with the terms of the decision during a specified period and up to a specified amount." The reference to the terms was meant to strike a balance between the assurance on which the member counted, and the need to safeguard the interests of the Fund. The provisions of the Articles required that all use of the Fund's resources be temporary. Paragraphs 5 and 11 had been included in each stand-by arrangement for that purpose, even before the use of performance criteria had been introduced. Many Directors had stressed the importance of the provisions of those two paragraphs, which could be applied in all cases in which the Fund found that the member should take additional action or that consultations should be held with the member when there had been misuse of Fund resources, and not only because of misrepresentation or nonperformance under an arrangement. Only the Executive Board could make such a finding.

Reference had also been made to Article V, Section 5, which again applied to all use of the Fund's resources, irrespective of whether it was made under stand-by arrangements, and whether or not the purchase was in compliance with performance criteria, the Director commented. It was quite simply a matter of use of Fund resources that was not consistent with the purposes of the Fund. The provisions of Article V could be invoked in all cases, including those of nominal observance, provided that the Executive Board, after appropriate examination, found that a member was making a use that was inconsistent with the Fund's purposes. The staff had not meant in any way to imply in EBS/84/94 that drawing rights could be interrupted automatically, or that a member could automatically be declared ineligible to use Fund resources. Article V, Section 5, also applied to purchases that had been made properly; for instance, its application was under consideration at present in respect of the failure of a member to repurchase at the appropriate time.

A member of course had a right to undo its improper use of the Fund's resources, thereby preventing the application of another remedial measure, such as the sale of a member's currency, the Director of the Legal Department concluded. No proposal had been made to include a clause in an arrangement calling for repurchase of an improperly made drawing because there was no express provision to that effect in the Articles. It was however a course of action that should be explored further. The use of the provision that permitted the sale of a member's currency had been suggested as a possibility because of the principle of parallelism with the rules for designation, under which a member could be designated even though it did not have a strong balance of payments position, if it had failed to comply with the requirement of need or with any reconstitution requirement that might be applicable. The legislative history of the Fund had made it clear that the principles applying to designation could also be applied to the sale of a member's currency.

Mr. Erb commented that some Directors had stressed that the Fund should not overreact to the small number of cases of misreporting. It seemed to him that even the few cases that had arisen had become public knowledge and thereby raised questions about the position of the countries involved. Little reliance was placed on trust in the real world. The response of the public had been rather to question the Fund's role, especially as it was generally believed that the Fund did indeed monitor and audit closely the performance and data of countries with Fund-supported programs. That was a false impression because there was indeed an element of trust in the relationship between the institution and its members; but the Fund's operations were still subject to public scrutiny when a country failed to meet its obligations.

Mr. Kafka observed that, as far as he knew, Article V, Section 5 had never been invoked to prevent a purchase because a performance clause seemed not to be adequately monitoring a program. Even consultations under paragraph 11 of stand-by arrangements had been rare.

The Director of the Legal Department confirmed Mr. Kafka's understanding. The staff had wished only to make the point that those provisions of the Articles existed, for use in exceptional circumstances--not as a matter of routine application--whenever the Executive Board found that there had been misuse of Fund resources.

The Chairman made the following summing up:

The discussion has been thoughtful and interesting, but it was of a preliminary nature; there was no intention to take decisions to change Fund policies at this meeting.

Directors considered that misreporting is not an extensive problem, and is actually a rare occurrence, but is a matter of legitimate concern, for various reasons.

- (1) On a technical plane, the effectiveness of Fund policies and of adjustment programs depends on the provision of accurate data.
- (2) The credibility of the Fund and of its "seal of approval" is at stake; numerous financial arrangements depend on it, and if there were doubts in the minds of outside observers about its reliability, the institution itself could be endangered.
- (3) The revolving character of Fund resources is also directly related to the quality of reporting; and if the Fund lets misreporting problems become more frequent, it might well have great difficulty in increasing its own resources.



(4) A relationship of mutual trust and good faith between members and the Fund is the essence of an institution based on cooperation.

(5) Equality of treatment demands that misreporting must not give one member any advantage over another member that complies with its reporting obligations.

In spite of the interest shown in the subject, and the legitimacy of the Board's concern, the staff paper has been criticized for having lumped together two very different issues: misreporting, either intentional or accidental, and, second, the problem of "nominal compliance" with performance criteria. Most Directors expressed the view that the latter problem had to do more with the adequacy of the design of programs and with the quality of the definitions of performance criteria than with misreporting as such.

Although not the direct object of the discussion, a most important conclusion drawn was that performance criteria were not ends in themselves, but rather guideposts on the road to medium-term balance of payments viability. Therefore, the question of the adequacy of performance criteria as they relate to the achievement of the objectives of programs should be taken up in the context of program design rather than of misreporting.

As for preventive measures, Executive Directors agreed that:

(1) The formulation and definition of performance criteria should be improved. The criteria have to be simple and clear, and neither complex nor numerous. Account has to be taken of the definitions used by countries. Questions of definition should be clarified to the greatest possible extent in technical memoranda attached to arrangements.

(2) Several Executive Directors underlined the importance of the administrative and statistical apparatus in member countries and the need at times for the Fund to help members to improve their data reporting systems by providing technical assistance. Countries should not be overwhelmed with data reporting requirements; it is the quality rather than the quantity of the data that needs improvement. The Fund should be able to rely on solid economic and financial data.

(3) A number of Directors expressed support for the use of performance criteria that can be measured on a continuous basis, although it was underlined that this method would be feasible only if the statistical conditions were adequate, and that it should be used with some caution.

(4) On the use of consultations to discuss and solve emerging reporting problems, the suggestion was not supported to use legal provisions in all stand-by and extended arrangements that would allow the Fund to interrupt drawings because of an emerging reporting problem. More and more often, arrangements incorporate midterm reviews of programs, which provide an opportune occasion to detect and resolve potential reporting problems in a spirit of good faith.

(5) Increased frequency of data reporting found some favor, but also aroused some doubts, because the accumulation of reporting obligations might impair the quality of the data.

While resident representatives can serve usefully in the promotion of understanding between the Fund staff and member countries, a number of Executive Directors warned that their role had to be looked at in a broader context; they doubted the effectiveness or advisability of utilizing such representatives to audit or monitor the accuracy of statistics.

On the remedial actions to be taken when reporting problems occur, it was agreed, first, that minor technical and temporary departures from a program, stemming from a reporting problem, should continue to be treated with flexibility; in appropriate cases, waivers or modifications of performance criteria would be proposed for approval by the Executive Board--where appropriate--on a lapse-of-time basis.

A more important issue was how to deal with instances of misreporting that had concealed substantial departures from a program. I was interested and heartened to note that the Executive Board, in its majority, had wisely warned the staff not to try to assign to the Board the judicial role of having to pass judgment on the reasons for the misreporting and to identify fraud as opposed to error. The magnitude of the misreporting measured in terms of departures from the program is a relevant basis for action; however, if fraud is flagrant and established beyond any doubt, it should be an element in the judgment of the Board, which has said that in such cases the Fund would probably be justified in imposing the maximum sanctions.

All cases of misreporting, whether motivated by an intention to conceal information and to draw on an illegitimate basis, or whether only the result of inaccurate reporting, should be brought by management to the attention of the Executive Board, which should decide what to do on a case-by-case basis.

The range of importance of the measures proposed for the consideration of the Board has been well understood.

The first and obvious step, if it is found out that there has been misreporting and that the program is no longer on track, would be to try to get it back on course; meanwhile, drawings will be interrupted until observance of the performance criteria has resumed, or an understanding on new measures has been reached.

When it is not possible to make proposals to the Board for bringing a program back on track quickly, obviously we have to do more. For many reasons, including the desire to ensure equality of treatment and consistency with the prompt repurchase expected under the compensatory financing facility, in case of overcompensation, a majority of the Executive Board is leaning in favor of an obligation to repurchase in respect of drawings that it has been established were made on the basis of substantive misreporting. Some legal questions have been raised that will have to be considered, but such a repurchase obligation is an interesting possibility; it would of course depend on the case in question, but the idea seems logical.

In an even more serious situation--if the repurchase obligation is not met, or if the misreporting is of a very grave nature--the provisions of Article V, Section 5, limiting a member's right to draw and eventually leading to a declaration of its ineligibility to draw, might have to be invoked, but only in very extreme cases, as I understand the Board's view. I have not seen much support for applying such methods retroactively to cases of misreporting that have occurred in the past. Moreover, the suggestion that the period of limitation should be two years was clearly acceptable.

Those are my reflections on the discussion. The staff will do further work, refining the criteria and proposing a line of action to the Executive Board. But I would like to reiterate that, while I agree that the quality and resolve of the adjustment effort of a member to ensure medium-term viability of its balance of payments rather than adherence to specific performance criteria are the main aims of a program, such criteria are nevertheless extremely important. For the time being, they are the only instrument we have for judging, in an objective and measurable way, the quality of the performance of a country under an arrangement with the Fund.

We should improve on the way we design our performance criteria, and the way we relate them to the more general objectives and targets of the program. But the instrument on which we have to base action, and if necessary to impose the sanction of interrupting drawings in case the program is not being carried out, has to be simple, reliable, objective, well understood by both parties to the arrangement, and must be monitorable.

Thus, we have to be very cautious in using such terms as "nominal compliance" with those criteria; although that is a fundamental issue, it is one for separate discussion. Above all, let us cast no shadow on performance criteria. Some comments made during the discussion, implying that too much importance was attached to performance criteria, could be counterproductive, and lead to a lax approach.

The Executive Directors concluded their review of legal and policy issues relating to reporting and other problems with performance criteria under stand-by or extended arrangements.

APPROVED: December 10, 1984

LEO VAN HOUTVEN  
Secretary