

11-1

INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 82/1

10:00 a.m., January 6, 1982

J. de Larosière, Chairman

Executive DirectorsJ. Anson
A. Buira

R. D. Erb

T. Hirao

R. K. Joyce
A. Kafka
B. KharmawanG. Laske
G. LovatoM. Narasimham
Y. A. NimatallahA. R. G. Prowse
J. SigurdssonAlternate Executive DirectorsO. Kabbaj
C. Taylor
M. A. Senior
O. Uçer, Temporary
A. Le LorierT. Alhaimus
T. Yamashita
F. A. Tourreilles, TemporaryJ. R. Gabriel-Peña
V. Supinit
F. Sangare
G. Winkelmann
C. P. Caranicas
M. K. Diallo, Temporary
A. S. Jayawardena
S. El-Khoury
T. de Vries
B. Legarda

Tai Q.

J. W. Lang, Jr., Acting Secretary
B. J. Owen, Assistant

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Also Present

African Department: O. B. Makalou, Deputy Director. Asian Department: J. Schulz. Exchange and Trade Relations Department: C. D. Finch, Director. Legal Department: G. P. Nicoletopoulos, Director; J. G. Evans, Jr., Deputy General Counsel; Ph. Lachman, A. O. Liuksila, S. A. Silard. Research Department: W. C. Hood, Economic Counsellor and Director; G. I. Brown, N. M. Kaibni, G. Khatchadourian. Treasurer's Department: W. O. Habermeier, Counsellor and Treasurer; D. Williams, Deputy Treasurer; D. Berthet, D. S. Cutler, D. Gupta. Personal Assistant to the Managing Director: N. Carter. Advisors to Executive Directors: S. R. Abiad, E. A. Ajayi, A. B. Diao, K. V. Jännäri, P. D. Peroz, Wang E. Assistants to Executive Directors: H. Alaoui-Abdallaoui, M. J. Callaghan, R. J. J. Costa, J. M. Jones, P. Kohnert, J. E. Leimone, J. S. Mair, M. Michelangeli, V. K. S. Nair, J. R. Novaes de Almeida, Y. Okubo, J. Reddy, J. Schuijjer, H. Suzuki, J. F. Williams, A. A. Yousef.

1. COMPENSATORY FINANCING FACILITY - REPRESENTATION OF INTENTION
AS TO REPURCHASE

The Executive Directors considered a staff memorandum on the legal character of the representation made by a member at the time of a purchase pursuant to paragraph 7 of the compensatory financing decision that it would make a prompt repurchase of any amount of overcompensation resulting from the use of estimated data (SM/81/234, 12/2/81). They also had before them a table listing compensatory drawings for shortfall years that included a number of months for which data had been estimated and that showed the amount of undercompensation or overcompensation in respect of those purchases for which final calculations of the shortfall had been completed by the staff (EBS/82/8, 1/13/82).

Mr. de Vries stated that the simple conclusions that he had reached from reading the staff memorandum were based on what seemed to him to be two self-evident principles. First, a member that had received resources from the Fund to which it turned out not to have been entitled should reimburse the Fund without delay. Second, if the authorities of member countries undertook formally to carry out certain actions in certain circumstances, the Fund should expect them to honor such representations.

Export shortfalls that might give rise to an entitlement to draw under the compensatory financing facility were determined with respect to the latest 12-month period preceding the drawing request for which the Fund had sufficient statistical data, Mr. de Vries recalled. However, in order to assist its members as much as possible, the Fund had since 1975 entitled countries in a difficult situation to make an advance drawing, so to speak, based on estimated data for up to 6 months of the shortfall year. The Fund had so far expected that, if those estimates proved to be wrong, the member would promptly return to the Fund the amount of resources it had received but to which it turned out not to have been entitled. He could not envisage that the Fund would abandon its commonsense policy and allow a member to keep resources to which it had not been entitled, or to repurchase them under a schedule as if it had in fact been entitled to them.

Thus, the question was how to ensure compliance with the simple principle that members should reimburse the Fund without delay under such circumstances, Mr. de Vries continued. It was made clear in the staff memorandum that there was a legal difference between a formal, legal obligation to repurchase on the one hand, and an expectation or a representation by the member that it would repurchase on the other. But it was also pointed out clearly that that difference did not matter much because for decades repurchases of the Fund's holdings of a member's currency had rested on declarations by members as to their intent to repurchase. It was in fact exactly 30 years since a proposal had been introduced, in January 1952, to adopt a policy stipulating repurchase within three to five years, based on that very technique of a declaration

of intent. Even though the Fund had had no specific legal authority to impose such a repurchase obligation formally until the Second Amendment to the Articles of Agreement had been adopted, the practice had in fact worked smoothly for 30 years.

Therefore, Mr. de Vries added, his conclusion was that the Fund did not face a serious or difficult problem and should simply continue its past practice. Of course, a member country that was in difficulty and that turned out to have drawn too large an amount under the compensatory financing facility would still have other resources available to it under the various policies that the Fund had established. He hoped that the Chairman would be able to conclude the discussion with a summing up reiterating the Fund's well-established principles, as well as the Executive Board's intention--on which he hoped there would be widespread consensus--to continue enforcing them. Members should then be informed of the reaffirmation of the policies under which the Fund would continue to take their representations seriously. Member countries could not of course be forbidden from making requests to be relieved of their promises to honor representations, but the Fund could inform them that it was its policy to look upon such requests with disfavor. The Executive Board would rely on the Managing Director to instruct the staff to carry out that policy and to obtain repurchase without undue delay in cases of overcompensation; if difficulties were encountered, the Chairman would in due course so inform the Executive Board, which would then have to consider what action to take. He did not expect that that would be necessary, because for many decades member countries had taken their representations to the Fund seriously, and if the Fund reaffirmed its standing policies, they would certainly continue to do so.

Finally, Mr. de Vries remarked, the request by the Sudanese authorities to postpone a repurchase of an overcompensated amount had provided a useful occasion to focus attention on the policy issues involved. He fully understood the difficulties being faced by Sudan, and in fact the Government of the Netherlands had, in connection with certain negotiations with the Sudanese Government, made a grant to Sudan of f. 24 million, an amount that was almost as large as the overcompensation that had occurred. Nevertheless, concern over the difficulties of certain countries was no reason for the Fund to abandon appropriate and responsible financial policies.

Mr. Erb said that he recognized that there was no legal obligation to repurchase on the part of a member pursuant to paragraph 7 of the compensatory financing decision, unless specific obligatory provisions were included in that decision or unless the Fund exercised its power under Article V, Section 4 in cases of purchases that involved a waiver of the 200 per cent limit. However, the presumption and practice had been that, once it became clear that a country using the compensatory financing facility had been overcompensated, prompt repurchase meant an immediate repurchase; in his judgment, that practice should not be

changed. The inclusion of the repurchase provision in the compensatory financing decision reflected broad agreement that members using the facility should not be overcompensated because of errors in estimating due to a lack of complete data for the shortfall year. Countries drawing under the compensatory financing facility had recognized that the additional degree of flexibility provided by the estimating procedure imposed on them a responsibility--one that was consistent with the cooperative character of the Fund--to make a prompt repurchase of any amount of overcompensation. He hoped that member countries would maintain that record.

Should the flexibility of the provision in the compensatory financing decision on the estimation of exports be misused in the future, Mr. Erb added, other procedures would need to be explored. Two possible solutions would be to amend the compensatory financing decision, either to make the repurchase provision a legal obligation, or to reduce the flexibility of the current procedure. He hoped that such actions would not be necessary, but that a general consensus would evolve to reconfirm what had been the practice in the implementation of paragraph 7 of the compensatory financing decision.

Mr. Sigurdsson remarked that the historical description in the staff memorandum of the development in the law of the Fund of the concept that neither a representation nor an expectation as to repurchase created a legally binding obligation showed clearly that there had been a rationale for introducing it into the provisions of the compensatory financing and buffer stock facilities as well as into the guidelines governing early repurchase in general. The logical justification for varying the degree of commitment to repurchase remained, and he saw no urgent need for a change in policy. The Executive Board had the necessary authority and flexibility under the present rules to ensure that the Fund's resources would be used in accordance with its purposes. In sum, the Fund had adequate legal authority to change existing or to create new repurchase obligations. Thus, the Executive Board should reaffirm existing policies.

Mr. Lovato observed that it appeared clear from the detailed statement provided in the staff memorandum of the concept of a representation to repurchase as it had been applied by the Fund in the past that from the legal point of view a representation did not imply a binding obligation. At the same time, it was also clear that, as opposed to the situation prevailing prior to the date of the Second Amendment, the Fund at present had the power to require a member to accept a repurchase obligation.

In that legal framework, which he fully accepted, the real question was whether or not it was preferable for the Fund to exercise the power it had to transform the representation contained in paragraph 7 of the compensatory financing decision into a binding obligation, Mr. Lovato considered. The good faith of member countries should be taken for granted and flexibility should be retained in the Fund's repurchase

policy. The experience of the past had been generally good, and he hoped that expectations to repurchase would normally be honored in the future as well.

In any case, Mr. Lovato remarked, the Fund was always in a position to preserve its interests by representing to the member that it should repurchase, as pointed out on page 8 of SM/81/234. For that reason, it would be advisable to maintain the present language of paragraph 7 of the compensatory financing decision. However, because doubts had arisen about the interpretation of the term "prompt repurchase," as the recent case of Sudan showed, he wondered whether it would be possible to make that term more specific while maintaining the nonobligatory character of the repurchase representation.

Mr. Laske remarked that the question under discussion had a legal and a policy aspect. He agreed with the legal interpretation given in the staff memorandum. Nevertheless, he recalled that when the similar question of repurchases in respect of overcompensation under the buffer stock facility had been discussed in the context of the Second Amendment, and when the compensatory financing decision had been revised in 1975, his chair had expressed a preference for making repurchases of overcompensated amounts a legal obligation on the part of the member, and not only in those cases where a waiver of the 200 per cent limit under Article V, Section 4 was involved. However, he was not pressing in any way for the matter to be reopened, and he accepted the present decision and legal interpretation.

As for the policy aspect, Mr. Laske continued, the practice of expecting a member to represent that it would repurchase promptly an overcompensated amount had worked well in the past. The question was to determine what was meant by "prompt repurchase." A country that had received assistance from the Fund, on the basis of an estimation, in an amount larger than it would have been entitled to if full and firm data had been available when a judgment with respect to the shortfall was being made, should be at least morally obligated to repay the excess promptly or, in other words, without undue delay. Strict criteria should be applied to an expectation by members representing that they would make a repurchase of an overcompensated amount. The staff had in fact convincingly drawn attention to the negative consequences for a country that did not live up to the representation it had made. Thus, there was already an element of urgency under present policies, indicating clearly to the countries concerned that it was in their own best interests to adhere to the representation they had made.

If cases of overcompensation based on the use of estimated data became more frequent than they had been in the past, Mr. Laske considered, it would be advisable to review the provisions of the compensatory financing decision relating to the use of estimated data as a basis for judgments on the amount of an export shortfall. For the time being, he was ready to reaffirm his support for the present policy, which was adequate and appropriate.

Mr. Hirao recalled that the early drawing procedure, which allowed members to estimate export earnings for up to six months of the shortfall year, had originally been introduced to relieve difficulties relating to lags in reporting trade data. According to the staff memorandum, the overcompensation that might arise from the use of estimated data did not in itself, in a strict legal sense, create a repurchase obligation for the member. However, it appeared to him to have become almost a recognized practice in the Fund for a member to repurchase promptly the amount by which it had been overcompensated. He fully agreed with Mr. de Vries that that good practice should be maintained.

Drawings under the compensatory financing facility offered certain advantages to member countries, Mr. Hirao observed, in terms both of conditionality and of cost, which should be distributed fairly among members. It would not be fair if the Fund treated members differently with respect to the repurchase of amounts drawn in excess of the actual shortfall simply because there were no legal grounds for a prompt repurchase obligation. One possible way for the Fund to ensure uniform and equitable treatment of members with respect to the repurchase of overcompensation would be to amend paragraph 7 of the compensatory financing decision by introducing a legal obligation, under the provisions of Article V, Section 7(d), on the prompt repurchase of the amount by which a member had been overcompensated.

There might be cases of a member not being able to discharge a prompt repurchase obligation because its reserve position was meager and its prospective balance of payments difficulties acute, Mr. Hirao commented. It could be argued that a member could use the Fund's general resources if its balance of payments position was weak when it incurred an obligation to repurchase promptly. But a member in such circumstances might have no further access to those resources for a variety of reasons. The Fund should then exercise some degree of discretion; for instance, a special provision could be introduced, authorizing the Fund to waive a member's obligation of prompt repurchase after consultation with the member with respect to its balance of payments difficulties. However, he would not object to any other way of attaining the same objective, and he would have no difficulty in going along with the approach advocated by previous speakers.

Mr. Prowse joined others in supporting the continuation of existing policy on the representation as to repurchase under paragraph 7 of the compensatory financing decision. The staff had mentioned in the conclusions in its memorandum that the requirement to repurchase under the compensatory financing decision could be made stricter. He would be opposed to any change in the legal nature of an expectation to repurchase an amount of overcompensation. It would be pointless to reduce the flexibility that the Executive Board would always need, as a matter of common sense, in considering such repurchases.

The members of his constituency attached great importance to the provision for making compensatory purchases on the basis of estimated data, Mr. Prowse observed. It was an extremely valuable aspect of the compensatory financing facility, particularly for smaller and developing members, which often had statistical systems that were not capable of producing the necessary data quickly. The Fund should therefore not be any more cautious in the future than it had been so far in approving drawings on the basis of estimated data. It was worth keeping in mind that the estimates were prepared basically by the staff and approved by the Executive Board, so that there was no question of any intended overcompensation.

There was a variety of policies in the Fund on repurchase, as the staff memorandum made clear, Mr. Prowse added. It would not be appropriate to reconsider in any fundamental way a specific requirement for repurchase unless the general policy on repurchase was completely overhauled.

In conclusion, Mr. Prowse stated, he confirmed his support for the existing formulation of paragraph 7 of the compensatory financing decision and for the present legal interpretation of it, which allowed the Executive Board a degree of flexibility in considering individual cases.

Mr. Anson said that he accepted the conclusion reached by the staff on the specific legal question that it had been asked to address, but the staff paper also raised issues of policy. He agreed with the view expressed during the discussion that the intention of the existing compensatory financing decision in respect of a member's representation to repurchase any overcompensation should be clarified and reaffirmed. There should be prompt repurchase of a purchase that, with the benefit of hindsight, should not have been made in the first place. The fundamental need was to have estimates that were as good as possible. As the table on early drawings showed, the record in that respect had been good and no adjustment had been needed in most cases. But any further refinement that the staff could introduce into its calculations to reduce the number of subsequent adjustments would obviously be helpful.

The staff memorandum dealt largely with the character of representations to repurchase, Mr. Anson observed, rather than with the underlying question of what was meant by a prompt repurchase. It might be possible to clarify the ambiguity inherent in paragraph 7 of the compensatory financing decision by setting a period within which the Fund would normally expect the repurchase to be made. On the basis of actual practice, as shown in the table of early drawings, most countries had interpreted a prompt repurchase to mean within about 30 working days, which would seem to be a reasonable time. In the future, if the repurchase had not taken place within that time, it would seem desirable to bring the case to the notice of the Executive Board, in such a way

that enough time was left for the member to discuss the matter with the Fund and agree on a suitable course of action. The question could also arise of how to deal with countries that had in good faith made a compensatory drawing that had subsequently been found excessive, but that still needed to make use of other forms of Fund resources to assist in carrying out the necessary adjustment.

If overcompensation and the need for prompt repurchase became more of a problem than it had been in the past, Mr. Anson added, the whole matter might need to be considered as part of a comprehensive review of the compensatory financing facility. Certain aspects of the facility were in fact shortly to be examined by the Executive Board, including the requirement of cooperation (EBS/81/251, 12/30/81). The staff should perhaps consider whether a member could be said to be cooperating with the Fund if it had drawn under the compensatory financing facility, in either the lower or the upper credit tranches, and had not made a prompt repurchase as required. It would appear, at least on the face of it, that any further compensatory drawing should be abated to the extent of any overcompensation that was still due to be repurchased.

Miss Le Lorier remarked that it might be useful to glance at the history of the use of representations as to repurchase under the compensatory financing decision, even though it was clear from the staff memorandum that, from a purely legal viewpoint, a representation was not a binding obligation. It would have been legally possible to impose a repurchase obligation in respect of any overcompensation when the decision had last been amended in August 1979. But the staff had given as its reason for not recommending any change in the provision on prompt repurchase the fact that "in none of the 11 cases reviewed so far has there been an overcompensation of the member" (SM/79/74, 3/15/79). As the table on early drawings showed, that was no longer the case, several member countries having been undercompensated or overcompensated. However, even if the assumption on which the staff had based its case in 1979 was still valid, she was not convinced that it would be relevant. In agreeing to the use of estimated data, the Executive Board had accepted the risk of overcompensation or undercompensation, and had in effect granted the staff and the purchasing member the right to make mistakes, a right that had not been abused, as demonstrated by the commendable accuracy of the estimates.

The frequency of overestimation or underestimation should be of less concern, Miss Le Lorier considered, than the consequences of overcompensation and the need for tightening the present provision for prompt repurchase. In her view, the provision could not be considered too lax; a representation to repurchase was not very different from an obligation, either in theory or in practice. Governments were expected to honor their representations, the nonobservance of which could have serious consequences for the member's credibility and its relations with the Fund, especially the financial ones under Article V, Section 5,

as noted in the staff memorandum. During the long period prior to the Second Amendment, the Fund had operated satisfactorily on the basis of members' representations as to their intention to repurchase. As far as the compensatory financing facility was concerned, the Fund had encountered only one or two cases since its amendment in 1975 of a member not being able to make a prompt repurchase.

For both the Fund and its members, Miss Le Lorier observed, a representation was a strong moral--if not a legal--commitment to make every endeavor to carry out their duty. Negligence in that respect would not be without risk, especially for the members most likely to suffer financially from a deterioration in their relationship with the institution. Moreover, the Fund's position would not be significantly improved if prompt repurchase was an obligation. If a member failed to heed the expectation that it would promptly repurchase any overcompensation, and if there was an improvement in its balance of payments and reserve position, the Fund already had the authority under Article V, Section 7(b) to turn an expectation to repurchase into an obligation. However, if the expectation became an obligation, and the member's failure to repurchase promptly was due to a depletion of its reserves, the Executive Board would be unable to avoid a decision on a postponement or a rescheduling of a repurchase, as it could at present. In all cases, due regard would have to be paid to the nature of the overcompensation, as well as to the individual circumstances of the member country.

In conclusion, Miss Le Lorier said, the Fund and its members would have to give the same significance to a representation as they had in the past. Perhaps the institution of a quarterly or a semiannual report to the Executive Board of all cases of overcompensation and of any eventual delays in the corresponding repurchase operations might stress the seriousness of the Fund's understanding of a representation.

Mr. Joyce commented that there could no longer be any doubt about the legal position, although as others had already said, the real issue was the appropriateness of existing policy with respect to the representation of intention to repurchase. An argument for not changing present procedures was that they had worked well. Whether or not they would continue to do so in the future depended basically on two questions. First, would the phenomenon of overcompensation become more frequent? The number of cases of overcompensation had been comparatively small on the last occasion when the matter had been raised; recently, their occurrence had increased, which might be either a passing event or a reflection of the world in which countries found themselves living. Second, how seriously would members interpret the representation to make a "prompt repurchase"?

Members would continue to take such representations seriously for a number of reasons, Mr. Joyce considered. Above all, members would not want to engage in practices that might call into question the general responsibility they shared for the good working of the institution, or the importance that they attached to the representations that

they made. Moreover, as had been pointed out, members were driven by a number of forces to act responsibly. The credibility of a member when it made a future request for consideration by the Executive Board was at stake. In addition, the Fund had the ultimate right under Article V, Section 5 to limit the use of its general resources by a member if it found that that use was not in accordance with the purposes of the institution. For developing countries, which were most likely to make use of the compensatory and buffer stock financing facilities, there was also a real danger that if enough members failed to repurchase as promptly as had been the practice in the past, the staff would adopt even more cautious estimating procedures. The outcome would inevitably be to the detriment of developing countries because the number of cases of undercompensation would be likely to grow.

While the future remained uncertain, the Fund should continue to pursue its present practices, Mr. Joyce stated. But he agreed with others that if the number of cases of overcompensation or of failure to repurchase overcompensated amounts promptly increased, it might be necessary to review the basic policy. Consideration might even have to be given at that juncture to whether or not there was a need for a provision permitting the expectation to repurchase to be turned into an obligation after a certain time and after there had been full consultation with the member. He hoped that that point would not be reached.

At present, the Executive Board should reaffirm existing policy and its understanding that the policy meant that repurchase would be prompt, Mr. Joyce stated. It might be useful to confirm what seemed to have been the practice: repurchase within a matter of 30 days, subject always to the need for flexibility in individual cases. It would also be helpful, whenever for one reason or another a member could not respect the 30-day period, for a report to be made to the Executive Board on the situation and on the steps being taken by the country concerned to carry out its undertaking to the Fund. Such a reaffirmation of present policy and re-emphasis on the importance that the Executive Board attached to representations to repurchase might make it unnecessary for the Fund to seek to follow the much more rigid procedure of converting an expectation or representation into a legal obligation.

Mr. Kafka said that he joined others in not favoring any change in the compensatory financing decision. It would certainly not be helpful to make the undertaking of prompt repurchase a legal obligation. The Articles of Agreement already offered adequate protection. However, it might be useful to make clear to a member making a compensatory drawing under the provision for estimating a shortfall that the Fund considered the undertaking to make a prompt repurchase with great seriousness and that it had in mind repurchase within about 30 days. As Mr. Anson had suggested, whenever that period was exceeded measurably--but without introducing too much rigidity--a report might be made to the Executive Board.

Mr. Kharmawan considered that a great deal of misunderstanding had been dispelled by the clear explanation in the staff memorandum of the provisions in the Articles with respect to early repurchase and their implications for the repurchase of drawings under special facilities, such as the compensatory financing, cereal import, and buffer stock financing facilities, in cases of overcompensation. An expectation to repurchase under paragraph 7 of the compensatory financing decision was clearly not a legal obligation; to make it one, a majority of 85 per cent of the total voting power would be needed to amend the decision. He was glad that the Executive Board was content with the present practice of expecting an early repurchase of any overcompensation under the facilities in question. Of course, if a member's balance of payments and reserve position had improved, the repurchase provisions of Article V, Section 7(b) would permit the Fund to convert the expectation to repurchase into an obligation.

It was of course necessary to maintain the flexibility that the repurchase provisions offered to member countries, Mr. Kharmawan continued. It was quite possible that a country that had benefited, so to speak, from an overcompensation might be in a difficult balance of payments and reserve position at the time it was expected to repurchase, and might moreover no longer have access to the Fund's general resources. To convert the expectation to repurchase under paragraph 7 into an obligation would deprive members of the flexibility afforded to them under the present provisions on early repurchase.

Nevertheless, Mr. Kharmawan stated, he shared the concern that had been expressed by others about the need for both the Fund and member countries to take an expectation to repurchase seriously. The proposal to interpret a prompt repurchase as one that would be made within 30 days was acceptable to him, on the understanding that if the repurchase had not taken place within the agreed period, the matter would be brought to the attention of the Executive Board, which would try to propose adequate steps if a re-examination of the member's situation showed that its balance of payments position did not permit it to repurchase.

Mr. Narasimham said that he could go along with the consensus that had emerged, namely, that no change should be made in the compensatory financing decision but that trust should continue to be placed in the responsible attitude of the Fund and in the good sense and good faith of its members. He had also been impressed by Mr. Kharmawan's point about the need for maintaining a degree of flexibility in the Fund's policies to allow for some extension of whatever period was defined as "prompt" to deal with the situation of countries that might be unable to repurchase, for reasons beyond their control, within the given time.

It had been suggested by some, Mr. Narasimham noted, that instances of overcompensation might increase in the future. Experience showed that there had not been many cases of variance between the original estimate of a shortfall and the actual outturn. He saw no reason to believe

that there would be any more such cases in the future than there had been in the past; even if there were, the Fund could continue to rely on the responsible behavior of its members because it had the authority to enforce certain sanctions, as indicated on page 9 of SM/81/234, should a member not honor its undertakings.

The availability of data did seem to affect the speed with which the staff was able to calculate a final shortfall, Mr. Narasimham observed. It had occurred to him that merely because of a delay in the calculation of the actual shortfall, one country might have the benefit of overcompensation for a longer period than another. He wondered whether the problem was a serious one and to what extent it might conflict with the principle of uniform treatment of members.

Similarly, Mr. Narasimham concluded, although the discussion had focused on how to tackle the problem of overcompensation, logic and symmetry would suggest that a member country might expect the Fund to provide additional resources promptly if it had been undercompensated for an export shortfall.

Mr. Alhaimus expressed his agreement with those Directors who felt that the present system of repurchase of any overcompensation under the compensatory financing facility on the basis of expectation had generally been functioning satisfactorily. As indicated in the table on early drawings, there had been only two requests for postponement of such repurchases over the past five years. Moreover, the major factor behind those requests had been continued difficulties in the balance of payments position of the members concerned. Another difficulty was that members needed time to make budgetary allowance for those unexpected repurchase obligations. There was therefore a strong case for maintaining the current system, which reflected the cooperative nature of the Fund, and embodied adequate flexibility mainly through the provisions of Article V, Section 7. Those provisions, while paying due regard to improvements in a member's balance of payments, did enable the Fund to request a member in a position to do so to make a firm representation to repurchase overcompensation. It was made clear in the staff memorandum that, although such a representation was not a legal obligation, its nonobservance might adversely affect the member concerned not only in terms of its relations with the Fund but also in respect to its external image. The mere existence of such likely negative effects constituted enough inducement for observance of an expectation.

Mr. Tai observed, first, that he agreed with the conclusion by the staff that the representation of repurchase was not a legal obligation, and second, that under present circumstances there was no need to change existing policy.

Mr. Kabbaj commented that the staff memorandum had led to an unusual consensus on the fact that there was no need to change the present system, which from the legal point of view had worked satisfactorily. As far as the Fund's policies were concerned, he tended to

agree with the proposal put forward by Mr. Kharmawan and Mr. Narasimham to retain flexibility for the Executive Board in the implementation of the system wherever it was justified.

Mr. Tourreilles said that he shared the view that the current system had served both the Fund and its members well in the past and that there was no apparent need to modify the procedure under which members made a representation of their intention to repurchase, or to transform the representation into a legally binding obligation. As the table on early drawings showed, intentions to repurchase had been promptly translated into actual repurchases in all but two instances of overcompensation under the compensatory financing facility. Furthermore, there had been no change in prevailing conditions to suggest that the current system would not continue to work in the future as well as it had in the past. To create a legal obligation for a country to repurchase an excess compensatory drawing, irrespective of its balance of payments position, would seem at best unnecessary because the current system had performed satisfactorily, would appear to be contrary to the cooperative character of the institution, and would also deprive members of needed flexibility.

Such a course of action might even open up a whole new set of issues relating to undercompensation under the compensatory financing facility, Mr. Tourreilles added. Binding a member country legally to the repurchase of an overcompensation while not allowing the same country any legal recourse in respect of an undercompensation would at the very least raise questions of symmetry of treatment.

Mr. Sangare noted the broad consensus on the staff's conclusion that the representation as to repurchase under paragraph 7 of the compensatory financing decision did not create a legally binding obligation. He expressed his agreement with those who had requested the continuation of current practice, but shared in particular the views of Mr. Kharmawan and Mr. Narasimham.

Mr. Buira said that he also joined the consensus that had emerged on maintaining the present system, which had operated very satisfactorily. It was clear from the staff memorandum that a representation by a member as to repurchase of overcompensation created an expectation but not a legally binding obligation to repurchase. Throughout its history, the Fund had distinguished between an obligation to repurchase and representations as to repurchase that did not give rise to obligations; it had not as a result been left without protection. As had been mentioned, the nonobservance of a representation by a member would damage its credibility and affect its relations with the Fund, including possible financial relations not only under the compensatory financing facility, but under other facilities. The Fund could limit access to its resources if it felt that a member was using them in a manner contrary to the purposes of the institution. Moreover, the Fund could turn an expectation into an obligation by representing to the member that it should repurchase--provided there was an improvement in its balance of payments and reserve position--under the guidelines for early repurchase pursuant to Article V, Section 7(b).

Experience since December 1975, when approval had been given under the amendment of the compensatory financing decision for the use of estimates, Mr. Buira recalled, showed that only 55 out of a total of 145 compensatory drawings had been based partly on estimates, many for periods of three months or less. For 41 of those 55 cases, the calculation of the actual export shortfall had been completed, indicating that there had been 7 cases of overcompensation, with 3 of them being for amounts of less than SDR 1 million. The staff estimates had thus proved to be accurate. Moreover, 5 of the 7 member countries that had been overcompensated had complied with the expectation and had effected the repurchase promptly; 2 had not, due to extremely difficult international reserve positions, but both countries had indicated that they would make the repurchases as soon as their liquidity positions permitted. Sudan had gone so far as to indicate that it would make the repurchase as soon as it drew under any new arrangement with the Fund. He was not sure that it was desirable to link drawings and repurchases in such a manner, either from the Fund's standpoint or that of the member, although that question should perhaps be discussed on another occasion. It should be noted, however, that such a link might give outsiders the impression that the Fund would approve programs to avoid defaults. That would be undesirable from the country's point of view, because the net flow of resources that it could receive would thus be immediately diminished, at least at the outset of the program, and the incentives to adjust might be greatly reduced.

He was confident that members would continue to do their utmost to comply with the expectation of prompt repurchase, Mr. Buira stated. Therefore, he saw no need to change the present provisions relating to repurchase, especially as converting the present expectation into an obligation would require an amendment of the compensatory financing decision, which could be introduced only by an 85 per cent majority, and would apply only to future holdings. Moreover, such an amendment would introduce an undesirable rigidity into members' repayment obligations. It would not be reasonable for a cooperative international institution to follow such a policy, which would not only be inconsistent with the balance of payments requirement to which drawings were subject, but also unnecessary if the member's balance of payments position was taken into consideration.

Finally, Mr. Buira remarked, he too had given thought to the possibility of automatic increases in drawings when it was established that there had been undercompensation of an export shortfall.

Mr. Uçer said that his chair was satisfied with the Fund's present practice. He associated himself with what had been said by previous speakers, especially by Mr. de Vries, although he would also welcome a more flexible interpretation of the decision with respect to undercompensation as well as overcompensation.

The Director of the Legal Department explained that, if the legal character of the representation as to repurchase remained unchanged, the Executive Board would not need to take a formal decision; it could reach an informal understanding for the guidance of the staff on what was meant by a "prompt" repurchase. Reference had been made by Mr. Anson to the actual practice of members of honoring their representations on repurchase within a period of one month. It should be noted that the concept of a "prompt" repurchase meant that the repurchase should be carried out as soon as it was operationally possible. The financial ability of the member to repurchase was not taken into account. If the Executive Board wished to agree on an understanding that "promptly" in the context of such representations meant within one month and that the staff would report to it immediately whenever a repurchase was not made within one month after the final calculation had been made, it could of course do so.

If a member's balance of payments position improved, it was possible for the Fund to adopt policies under Article V, Section 7(b) under which the expectation to repurchase would be transformed into an obligation, the Director of the Legal Department confirmed. If the repurchase became an obligation in that way, all the provisions on repurchase obligations would be applicable, including those that permitted the Fund in exceptional circumstances to grant an extension of the period of repurchase. The effect of a member's continued nonobservance of a representation to repurchase under the compensatory financing facility, especially if the member's position had improved, could also be considered in connection with the requirement under the decision that the member should cooperate with the Fund in finding a solution to its problems. The Executive Board had received a staff paper on the application of the requirement of cooperation to purchases under the compensatory financing facility (EBS/81/251, 12/30/81). When the subject came up for discussion, the staff would be able to offer any further thoughts that it might have on the matter.

The staff was required to complete the final calculation of an export shortfall as soon as possible, the Director explained. A member that had been undercompensated had the right, if it wished to obtain additional compensation, to submit a request to the Fund in accordance with the compensatory financing facility decision for consideration by the Executive Board as soon as the data became available.

The Treasurer added that the concept of a "prompt" repurchase, which had not been defined precisely, had come to mean in practice about four to five weeks, for the reason that it could take that long for the staff to inform the member and the Executive Board, and for the member to verify the calculation. In addition, in some instances, the overcompensation might be unexpected by the money managers who were required to make an immediate disinvestment--possibly at a loss--in order to repay the Fund. The concept of a "prompt" repurchase was therefore an operational one, with a time dimension that meant as soon as possible in the circumstances of the case. It had not been found necessary to extend

the repurchase period beyond more than a limited number of weeks, but even if it were to be understood that the interpretation of "prompt" would normally mean within one month, it would be advisable for the Executive Board to formulate its understanding flexibly, so that there would be no difficulty if the staff reported to the Board in, say, the fifth week.

The staff representative from the Research Department said that when members wished to make early drawings on the basis of estimated data for the shortfall year, the staff and the authorities of the member concerned together took the utmost care in trying to make reasonable estimates. Errors had been infrequent in the past, but it would be difficult to predict the record in the future. The number of members availing themselves of the early drawing procedure had of course increased.

A practical problem was encountered from time to time in making a speedy final calculation of the shortfall, the staff representative noted. Sometimes data became available after a considerable delay, and the staff had to make a special effort to obtain the required data, for instance, on the occasion of Fund missions to member countries. Thus, it could be several months before the staff obtained final data that were comparable with the data used in the calculation of the original estimates. The staff had to accept the fact that ensuring the timely availability of data was a long-term problem for some countries, and that special efforts had to be made from time to time to speed up the provision of information. As soon as actual data for the period concerned became available, the staff reported the final calculation of the shortfall to the Executive Board. In the event of overcompensation, the member was informed simultaneously of the need to make a prompt repurchase of the amount, and the Executive Board was informed of the repurchase in the twice-monthly report on transactions.

Mr. Prowse commented that increasing demands on the compensatory financing facility were to be expected, given the collapse in the prices of commodities. The fluctuation of prices also made it difficult to estimate export shortfalls. In less stable conditions, overcompensation and undercompensation were likely to increase.

Although he himself had not intended to raise the matter of undercompensation, to which he had referred on a previous occasion, Mr. Prowse recalled, he would be interested in having confirmation of the legal position, as explained by the Director of the Legal Department; i.e., that a member had the right to request a further purchase if the use of estimated data led to an undercompensation of an export shortfall. If the member did have that right, he asked whether or not there would be any limitation on the period during which a member could reopen the matter of the estimates on which the undercompensation had been based.

The staff representative from the Research Department explained that the amount of undercompensation or overcompensation, as shown in the table on early drawings, took into account the quota limits that

applied to drawings under the compensatory financing facility at the time of the purchase. The amount of overcompensation or undercompensation had to be measured against the quota limits existing at the time of the drawing. It would be recalled that until August 1979, the limit on drawings had been 50 per cent of quota in any 12-month period with a maximum of 75 per cent of quota on outstanding drawings; the annual limit had then been abrogated and the overall ceiling raised to 100 per cent of quota. If the final calculation of the shortfall confirmed undercompensation, there might be a considerable lapse of time before a further request for a compensatory drawing was made, and any new request was judged on its own merits.

Mr. Narasimham said that he recognized that the speed with which the staff calculated the final shortfall was a practical matter. His point was more one of equity between members. The question was whether or not consideration could be given to making some allowance for the differences in speed in reporting the final calculation to the Executive Board. After all, earlier reporting based on the availability of statistics meant that some countries had to repurchase the overcompensation with greater promptness.

Mr. Buirra asked for confirmation of his understanding that if a member country was overcompensated, it was expected to repurchase promptly, perhaps within 30 days, although a member that was undercompensated was not automatically entitled to make a further drawing but had to submit a new request, which would have to be brought before the Executive Board for its decision. As a result, the undercompensated member would have to wait much longer than 30 days and would have no certainty of being able to make the drawing. The country might have been cooperating with the Fund in carrying out a program and might either have deviated from one of the performance criteria or not be able to meet one of those criteria in the future. There was an asymmetry between the automatic procedure whereby a country had to repay an overcompensated amount very quickly and the lengthy procedure that had to be followed when a member had been undercompensated. He wondered whether the amount of undercompensation to which the member was entitled should not be made automatically available, subject only to the quota limits and to the determination that there had actually been an undercompensation.

The Chairman commented that such a case could be argued in strict logic, but that there was another way of looking at the matter. Overcompensations and undercompensations stemmed from the flexibility of the compensatory financing decision, which allowed members to draw on the basis of estimates if they could not readily provide the statistics. The best way to avoid undercompensation would be to resume the initial practice of asking members to provide complete data. As long as the Fund maintained its flexible policy of accepting estimated data, there would obviously be a risk of overcompensation or undercompensation. There was no complete parallelism or symmetry between the situation in

which flexibility had led to a transaction that had to be reversed and a situation in which it had led to undercompensation, the risk of which the country had accepted at the outset. It was normal for a member country to ask for the undercompensation to be corrected, but he did not see a case for automatic payment of the undercompensated amount without any decision by the Executive Board.

The Director of the Legal Department confirmed that in a legal sense members had no automatic entitlement to additional compensation to offset any undercompensation that might have occurred. Under the existing decision, it was possible for the member to request a new purchase for the same shortfall year when the data for that year became available. On the assumption that it met the requirement of cooperation, it would then be able to draw an additional amount, based on calculations made at the time of the request in accordance with the decision, that would fully compensate for the export shortfall in respect of that shortfall year.

Mr. Buira said that he was satisfied with the present system. He had wished only to draw attention to the existence of the asymmetry.

Mr. Joyce remarked that final data were of course likely to differ from the estimates, but he wondered what the staff did if the final data were themselves revised one or two years later; presumably, it would take no action, correctly in his view.

The Director of the Legal Department responded that no automatic adjustments were made to the calculations because of revisions in the data. Again, a member that felt it was qualified to request an additional drawing on the basis of the latest data could do so.

Mr. Erb asked how later revisions of the data would affect a member that had been overcompensated.

The Director of the Legal Department replied that the staff made the final calculations as soon as possible after receiving the data and presented them to the member. The matter was not subsequently pursued in a later year in order to make further revisions.

The staff representative from the Research Department confirmed that the matter was not pursued with the member. However, past data were revised--mostly to a minor but sometimes to a more significant extent--when countries had made subsequent requests under the compensatory financing facility. In such cases, shortfalls were calculated on the basis of the latest data provided at the time of the request. An attempt was made, however, in the papers submitting such requests to the Executive Board to examine ex post the calculations relating to previous drawings to show whether or not, based on the latest actual data for the five-year trend period, the previous purchase had overcompensated or undercompensated for the shortfall. The exercise was undertaken for purposes of information, and not for the purpose of making corrections with respect to previous drawings.

The Chairman stated that representations by members on repurchase were of great importance for members and for the Fund itself. As a financial institution, the Fund had to be repaid. Its good record in the past was unique; it had had no default except in very few exceptional cases. It was essential for members to honor their moral undertakings in a timely fashion. If the word spread that the Fund did not obtain prompt repayment under such undertakings, the institution would have no future because it would be unable to raise funds.

In response to Mr. Buira's remarks on the problem of the repurchase arrangements for Sudan, the Chairman noted, it had been obvious to the management and staff that a new program could not be presented to the Executive Board unless Sudan had cleared up its position--not only on its drawings from the Fund under the compensatory financing facility and the oil facility but also on charges. When Sudan had repaid its outstanding obligations, and if the Executive Board agreed on a future program for Sudan, the authorities would repay immediately the total amount of overcompensation under the compensatory financing facility. The Sudanese authorities and the staff had reached a clear understanding and had, in good faith, agreed on those procedures.

It was very important not to leave any doubts about the attitude of the Fund to the way in which members honored their undertakings, the Chairman observed. As recent cases had shown, member countries had recognized the primary importance of being in good standing with the Fund if they wished to make use of the Fund's resources.

The Chairman then summed up the sense of the meeting as follows:

The Executive Board approves the legal interpretation given by the staff in SM/81/234.

The Executive Board agrees for the time being not to change the legal status of a representation to repurchase any amount of overcompensation under the compensatory financing facility.

The Executive Board agrees to maintain the present and past practice under which an overcompensated member would continue to make prompt repurchases, and emphasizes the importance it attaches to maintaining the high standards of prompt repurchase that have generally characterized past experience.

More specifically, the Executive Board agrees, in the light both of past practice and of the nature of overcompensation, that prompt repurchase in the context of the compensatory financing facility decision would mean that the repurchase would normally be made within a period of 30 days. That understanding should be made clear from the start to members that might be in a position to experience an overcompensation problem in the future.

If the normal period of prompt repurchase referred to in paragraph 4 cannot be respected, a report will be made to the Executive Board within a period of up to two weeks as judged necessary by the management and Treasurer, which report should normally be accompanied by a proposal on how to deal with the question in the most prompt and appropriate manner.

Should experience in the future show an increase in the frequency of cases of overcompensation, or a deterioration in the repurchase behavior attaching to such cases of overcompensation, the Executive Board would review the whole policy issue.

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/81/163 (12/28/81) and EBM/82/1 (1/6/82).

2. BELGIUM - EXCHANGE SYSTEM

The Fund's approval under Decision No. 6537-(80/97) of Belgium's multiple currency practice is extended until the completion of the 1981 Article IV consultation with Belgium. (EBD/81/333, 12/28/81)

Decision No. 7030-(82/1), adopted
December 31, 1981

3. CYPRUS - EXCHANGE SYSTEM

The Fund's approval of Cyprus' restriction on payments and transfers under Decision No. 6921-(81/109) is extended until the completion of the 1981 Article IV consultation with Cyprus. (EBD/81/331, 12/23/81)

Decision No. 7031-(82/1), adopted
December 30, 1981

4. ICELAND - EXCHANGE SYSTEM

The approval of Iceland's multiple currency practice under paragraph 2 of Decision No. 6686-(80/175), adopted December 3, 1980, is extended until the completion of the 1982 Article IV consultation with Iceland. The Fund encourages the Icelandic authorities in preparing the fiscal 1983 budget to adopt solutions which would allow elimination of this practice as soon as possible. (EBD/81/330, 12/23/81)

Decision No. 7032-(82/1), adopted
December 30, 1981

5. TURKEY - EXCHANGE SYSTEM

The Fund welcomes the progress made by Turkey in reducing multiple currency practices. The Fund approves the retention by Turkey of the remaining multiple currency practice arising from the operation of the export retention scheme as described in EBS/80/126 until the forthcoming review of the stand-by arrangement for Turkey, or until February 28, 1982, whichever is earlier. (EBS/81/250, 12/29/81)

Decision No. 7033-(82/1), adopted
December 31, 1981

6. ZAIRE - EXCHANGE SYSTEM

The approval of Zaïre's exchange restrictions under Decision No. 6244-(79/146), extended by Decision No. 6717-(81/1), with changes as described in EBS/81/126 and EBD/81/172, and extended by Decision No. 6896-(81/96), is further extended until the completion of the 1981 Article IV consultation. (EBD/81/332, 12/23/81)

Decision No. 7034-(82/1), adopted
December 30, 1981

7. AFRICAN CENTRE FOR MONETARY STUDIES - TECHNICAL ASSISTANCE

In response to a request by the African Centre for Monetary Studies for technical assistance, the Executive Board approves the proposal set forth in EBD/81/336 (12/30/81).

Adopted January 4, 1982

8. MOROCCO - TECHNICAL ASSISTANCE

In response to a request from Morocco for technical assistance, the Executive Board approves the proposal set forth in EBD/81/335 (12/29/81).

Adopted January 5, 1982

9. ASSISTANT TO EXECUTIVE DIRECTOR

The Executive Board approves the appointment set forth in EBAP/81/396 (12/28/81).

Adopted December 30, 1981

10. EXECUTIVE BOARD TRAVEL

Travel by Executive Directors as set forth in EBAP/81/397 (12/29/81), EBAP/81/399 (12/29/81), and EBAP/81/402 (12/29/81) and by Advisors as set forth in EBAP/81/400 (12/29/81) and EBAP/81/401 (12/29/81) is approved.

APPROVED: June 10, 1982

LEO VAN HOUTVEN
Secretary

