

INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 85/41

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

J. de Larosière, Chairman

Executive Directors

C. H. Dallara

M. Finaish

H. Fujino

G. Grcsche

J. E. Ismael

A. Kafka

F. L. Nebbia

Y. A. Nimatallah

G. Salehkhoul

N. Wicks

Zhang Z.

Alternate Executive Directors

N. Toé, Temporary

H. G. Schneider

X. Blandin

M. Sugita

B. Goos

Jaafar A.

L. Leonard

H. Fugmann

A. Abdallah

B. Jensen

J. E. Suraisry

G. Ortiz

J. de Beaufort Wijnholds

A. V. Romuáldez

O. Kabbaj

A. S. Jayawardena

T. A. Clark

L. Tornetta, Temporary

Wang E.

L. Van Houtven, Secretary

S. J. Fennell, Assistant

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Also Present

African Department: F. d'A. Collings, J. C. Williams. Asian Department: R. M. Broadway, G. Szapary. European Department: S. Mitra. Exchange and Trade Relations Department: G. Begashaw, J. T. Boorman. External Relations Department: A. F. Mohammed, Director; H. O. Hartmann, G. P. Newman. IMF Institute: O. B. Makalou. Legal Department: G. P. Nicoletopoulos, Director; J. G. Evans, Jr., Deputy General Counsel; W. E. Holder, Ph. Lachman, S. A. Silard. Secretary's Department: A. P. Bhagwat. Treasurer's Department: W. O. Habermeier, Counsellor and Treasurer; D. Williams, Deputy Treasurer; J. E. Blalock, D. H. Brown, J. C. Corr, D. Gupta, B. E. Keuppens, T. B. C. Leddy, G. Wittich. Western Hemisphere Department: M. Caiola. Bureau of Statistics: W. Dannemann, Director; J. B. Gupta, D. K. McAlister, J. B. McLenaghan. Personal Assistant to the Managing Director: S. P. Collins. Advisors to Executive Directors: A. A. Agah, L. K. Doe, P. Péterfalvy, G. W. K. Pickering, T. Sirivedhin, E. M. Taha, D. C. Templeman, A. Vasudevan. Assistants to Executive Directors: E. M. Ainley, I. Angeloni, W.-R. Bengs, J. Bulloch, M. B. Chatah, J. de la Herrán, A. K. Diaby, G. Ercel, V. Govindarajan, G. D. Hodgson, Z. b. Ismail, A. K. Juusela, H. Kobayashi, R. Msadek, K. Murakami, E. Olsen, W. K. Parmena, M. Rasyid, D. J. Robinson, J. E. Rodríguez, C. A. Salinas, A. A. Scholten, Shao Z., E. L. Walker, Wang C. Y., B. D. White.

1. OVERDUE FINANCIAL OBLIGATIONS TO THE FUND - ACCOUNTING FOR CHARGES FROM MEMBERS; REPORTING BY THE FUND; AND PUBLICITY UPON DECLARATION OF INELIGIBILITY

The Executive Directors continued from the previous meeting (EBM/85/40, 3/13/85) their consideration of a staff paper on the reporting of overdue financial obligations by the Fund and on the effects of overdue payments on the Fund's income and reserves (EBS/85/32, 2/5/85; and Cor. 1, 2/28/85), in the form of supplementary notes to the six-monthly report on overdue financial obligations to the Fund (EBS/84/211, 10/11/84) and to a paper on the effect on income and the treatment in financial statements of overdue obligations to the Fund (EBS/84/231, 11/14/84), which had been discussed at EBM/84/166 and EBM/85/167 (11/19/84). They also had before them a staff paper on the question of publicity in cases where a member was declared ineligible to use the general resources of the Fund (SM/85/12, 1/9/85).

Mr. Leonard remarked that the Fund should make proper financial allowance for the existence of overdue obligations once they became of a material amount and once there was uncertainty about when they would be repaid. It made little sense for the Fund to include as actual income charges that had accrued but were unlikely to be received. Likewise, it would be a mistake if reserves were not set at a level that took account of overdue payments. He therefore supported action along the lines of the proposal in option (b) of the Chairman's statement. ^{1/} He was not certain, however, that increasing the annual income target in line with the formulas presented in Attachment III of EBS/85/32 was the most useful approach. Total reserves should be considered adequate not only in terms of the uncertainties arising from overdue payments but also in terms of other identifiable contingencies. The need for reserves, other than to cover eventual nonpayment of obligations, scarcely required reserve levels as high as the present SDR 1 billion. A small annual surplus on the Fund's accounts was probably sufficient to ensure the institution's reputation for sound financial practices.

Total overdue payments currently represented about 15 percent of reserves, while total use of Fund credit by those members that were overdue in their obligations to the Fund by six months or more was equivalent to about 68 percent of reserves and could reach 100 percent of reserves by the end of the decade, Mr. Leonard noted. Were there other indicators that should be examined in determining the adequacy of reserves and, if so, what could the Executive Board deduce from them? If the present level was inadequate in the light of all relevant indicators, what would be a more appropriate level of reserves and how fast should the Fund try to approach that level? What would be the effects of any penalty charges that the Fund might decide to impose on members with overdue obligations? Those questions should be borne in mind and examined further before decisions on the Fund's income target and level of reserves were taken.

^{1/} See Appendix.

Opposing positions on the question of reporting by the Fund of overdue obligations could be argued with equal validity, and the approach to be adopted might ultimately turn on the question of the Fund's style, Mr. Leonard considered. It could be argued that full disclosure of overdue payments was the best way to preserve the Fund's credibility and that the practice of commercial banks regarding reporting of overdue obligations was not entirely relevant to the Fund, which was in a different position. Because of its important role and particular responsibilities in the international financial system, the Fund reported more information on its financial relations with members than would a commercial bank. Lending and borrowing arrangements with member countries were a matter of public record through the issuance of press releases and reporting in International Financial Statistics (IFS). The public availability of such information was understandable as the Fund's resources were made up in the main of quota contributions from national governments, which had an obligation to the taxpayers to account for the use of their assets. Moreover, reporting of information on overdue obligations would prevent situations from arising in which members were inaccurately suspected as having overdue obligations. The Fund should be in a position to comment should a member choose to make public its situation with respect to the Fund. Finally, publicity might prevent the emergence of overdue obligations on the part of other countries.

For the afore-mentioned reasons he favored reporting all decisions on overdue obligations in the Annual Report, Mr. Leonard stated. Their exclusion would be contrary to the role of the Annual Report as the vehicle through which important decisions of the Fund were routinely communicated. He was not clear how overdue obligations should be treated in the Annual Report, but he would examine the staff's proposals when they were presented to the Executive Board. Overdue financial obligations to the Fund of members having obligations overdue for six months or more should also be reported in the quarterly financial statements. Although reporting of that kind would, in some way, override the confidentiality of relations between the Fund and members with overdue obligations, it would permit observers to evaluate the seriousness of the arrears problem and to prevent them from guessing which countries were in arrears to the Fund.

On the whole, his chair leaned in the direction of the view he had just outlined, Mr. Leonard remarked. There were some countries in his constituency, however, that did not hold that view. In their opinion, more weight should be given to the sensitivity of the relationship between the Fund and member countries with overdue obligations. They felt it important to distinguish between those members that had been declared ineligible to use the Fund's resources because of such overdue obligations and those that were as yet only in arrears. There should be differences in the standing of the two categories of members in the eyes of the Fund. Those in the second category were, it could be argued, entitled to more considerate treatment by the Fund; they should not be judged as having defaulted in their obligations but as being unable to meet them on time owing to temporary difficulties. The Fund should not damage the standing

of those members in the eyes of the international community or inhibit them in any way from meeting their obligations. The authorities of one country in his constituency felt strongly that such a danger should be avoided. The status of a member with respect to the Fund could easily be determined by a legitimate inquirer. The publication of detailed information on individual members simply in arrears might do little to encourage members to repay the Fund. Furthermore, the commercial banks, the World Bank, the Inter-American Development Bank, and other financial institutions did not identify individual borrowers in arrears.

He favored the issuance of a press release upon declarations of ineligibility, Mr. Leonard indicated. The Annual Report was published only once a year, and to provide equal treatment for all members, decisions on ineligibility should be publicized in the intervening period. A delay in issuance of the press release for two to four weeks after the Executive Board decision might provide an incentive for the country concerned to repay its obligations and might prevent the Board's delaying a decision on ineligibility out of concern that the declaration would have to be made public immediately. Another consideration was that the issuance of a press releases when a country was declared ineligible would also mean that another notice should be released when a country cleared its arrears. However, the likelihood of a declaration of ineligibility leaking to the press recommended an immediate issuance of a press release. The release should include a brief description of Fund policy on declarations of ineligibility, a short outline of the amounts of arrears owed by the country, and perhaps the length of time the longest overdue payment had been outstanding. Correspondingly, he did not object to such detail being published in other Fund documents, including the statistical publications.

Mr. Toé agreed that the problem of overdue obligations to the Fund was important. A careful examination of all the issues related to overdue obligations was called for in order to find appropriate solutions to resolve the problem and to avoid a recurrence of such a problem in the future. He was in favor of increasing the Fund's reserves in order to strengthen the financial position of the Fund should circumstances warrant such an increase. The Fund, though a unique and cooperative institution, should have a strong financial base. He was not of the opinion, however, that the problem of overdue obligations per se warranted a change of Fund policies on charges, income, and reserves, and he therefore was opposed to both options presented by the Chairman. The burden resulting from an increase in the reserve target would fall solely on borrowers, irrespective of whether they discharged their obligations to the Fund on time, while nonborrowing members would not share any of the burden. The efforts to strengthen the Fund's financial position through increases in its reserve target should be the responsibility of the membership as a whole. Given the increasing amounts of overdue obligations, the question of the adequacy of the Fund's reserves should be addressed comprehensively at the time of the annual review of the Fund's income position, on the basis of an in-depth study that his chair had suggested at EBM/84/185 (12/17/84).

He supported the reporting of overdue financial obligations to the Fund of members overdue for six months or more in aggregate in the quarterly financial statements, Mr. Toé stated. The staff had indicated that other financial institutions did not report on arrears, and he therefore suggested that the references currently made to individual members in the notes to the financial statements be deleted. He hoped that if the Executive Board agreed to report in the Annual Report on decisions on complaints with respect to overdue obligations, that reference would be made only to the number of countries involved. He was opposed to reporting of overdue financial obligations in other Fund publications.

He was unclear about the objective of issuing a press release upon declarations of ineligibility, Mr. Toé remarked. While the benefits of such action for the Fund were unclear, the spirit of cooperation between the members and the Fund would certainly be harmed. He was therefore opposed to active publicity upon declarations of ineligibility.

Mr. Wijnholds remarked that the Fund's financial position clearly needed to be protected as a result of the increase in overdue payments. If the Executive Board failed to act, the consequences could be serious and damaging to all members of the Fund. Directors should, however, be mindful of the need to keep the rate of charge as low as possible. His chair did not have strong preferences for either option (a) or option (b) presented by the Chairman; there were merits to both approaches. It was important for the Executive Board to reach a decision at the present meeting, given the urgency of the problem. He supported an increase in the reserve target, as proposed in both options. The range of increases in the reserve target proposed in the staff paper would lead to only a modest increase in the rate of charge. There was also much to be said in favor of placing unpaid charges from members that were overdue in meeting financial obligations for six months in nonaccrual status, although it would be preferable if such action were taken on an automatic basis and was not subject to deferral by management. The Netherlands authorities agreed with the staff that provisioning for overdue repurchases should be considered if and when the collectibility of the obligations owed by a member were seriously in doubt.

He agreed with the staff that Executive Board decisions on overdue obligations should be reported in the Annual Report in an appropriate format that should be determined when preparing the 1985 publication, Mr. Wijnholds commented. He was not certain that individual reporting of members with overdue obligations in the Fund's statistical publications would be beneficial, although he would favor identifying those members that had been declared ineligible to use Fund resources.

A press release should be issued immediately following an Executive Board decision on ineligibility, Mr. Wijnholds considered. The member country would have had sufficient time prior to the Board meeting to take action to reduce its overdue obligations. A delay in issuing the release

was therefore not warranted and was likely to be pre-empted by leaks to the press. The press release should not include the Fund's views on action that the member should take.

Mr. Nebbia observed that overdue obligations had a negative impact on the Fund's financial position. Measures should be taken to strengthen the Fund's financial position and to deal with the problem of overdue payments. Option (a) in the Chairman's statement would strengthen the Fund's position by increasing the reserve target to take account of overdue obligations existing during any period of time. Option (b) proposed a change to nonaccrual accounting for charges, together with a somewhat smaller margin in the reserve target. Both options involved an increase in the reserve target and would, therefore, lead to an increase in the rate of charge, thereby imposing a heavy burden on the users of Fund resources. Such an undesirable development should be avoided as member countries that were currently making considerable efforts to adjust their economies under Fund-supported programs would be punished with higher rates of charge. Members that were not using Fund resources would not share the burden arising from an increase in the reserve target.

Inequitable burden sharing represented a departure from the cooperative nature of the Fund and would have a negative impact on the adjustment process in countries currently implementing Fund-supported programs, Mr. Nebbia remarked. He supported Mr. Jayawardena's proposal to postpone a decision on an increase in the reserve target until the staff had prepared a paper on burden sharing. If a decision had to be taken at the present meeting, option (b) was the more tolerable. He would be interested to learn of the implications of a reserve target increase on both creditor and debtor members of the Fund.

He did not favor individual reporting of overdue obligations in any Fund publications, although he agreed that to preserve the financial integrity of the institution, financial statements of the Fund should contain information on overdue obligations on an aggregate basis, Mr. Nebbia stated. Such a course of action would be entirely consistent with the current practices of other financial institutions, and it was unnecessary for the Fund to be innovative in that respect, particularly given the Fund's unique position.

He was opposed to the issuance of a press release upon, or shortly after, an Executive Board decision on ineligibility, Mr. Nebbia observed. The decision itself was cause for concern for the member involved, and active publicity would serve only to increase the confrontation between the Fund and the member concerned, without contributing to the aim of encouraging the member to settle its obligations promptly. Members should be encouraged to avoid making late payments to the Fund in a more positive way than through active publicity. Close collaboration between the Fund and a member should continue to be the key element in the settlement of arrears. By maintaining contact with the member, the Fund would

be in a better position to judge the effort that it was making to resolve its payments arrears, even after it had been declared ineligible to use Fund resources.

Mr. Romuáldez stated that he shared the concerns of other Directors about the impact of growing overdue payments on the Fund's financial position. His chair had considered for some time that a review of the Fund's reserve target was called for independently of the increase in overdue payments, particularly as the Fund's reserves relative to its activity, as measured by various indicators, had declined. The increase in overdue obligations had served merely to reinforce the need for a more prudent policy on reserve accumulation. The view of his authorities on that issue had been presented in previous discussions.

His authorities were concerned that a move to nonaccrual accounting for charges would undermine what should remain the Fund's basic assumption that all overdue charges would ultimately be discharged, Mr. Romuáldez commented. Moreover, a move to nonaccrual accounting should not be considered independently of the need to make special provisions for overdue repurchases and charges. The point had not yet been reached, however, at which those issues should be considered by the Executive Board.

On the reserve target, in the past his chair had suggested that the net income target be linked to the level of overdue obligations, based on an approach that combined the flexibility of an ad hoc approach with the discipline of a formula, Mr. Romuáldez remarked. Of the formulas proposed in EBS/85/32, he supported Formula 1, which would result in less erratic fluctuations in the income target and the rate of charge than under the other formulas.

A straightforward increase in the income target to, say, 6 percent had some advantages, as it would avoid the complexity of a formula approach and any notion of precision, which would be spurious, Mr. Romuáldez indicated. He could not support such an approach, however, as it would be arbitrary. Should Directors favor the Chairman's suggestion to increase the reserve target from 3 percent to, at a minimum, 6 percent, he could go along with it.

In general, he supported the disclosure of information on members' arrears to the Fund, Mr. Romuáldez stated. Nevertheless, he had some reservations about the disclosure of detailed information on amounts overdue by individual member countries, which might be counterproductive, as much to the member concerned as to the Fund, in some situations. If details of members' overdue obligations were to be disclosed on an individual basis, scrupulous attention should be paid to ensuring that all cases were treated in a uniform manner. The proposals on reporting of overdue obligations in Fund publications did not appear to pay sufficient attention to that requirement. For example, as financial statements related only to the accounting balance on a particular date and there were only four such dates in each year, there was the potential that members would be treated differently depending on how the overdue obligations

related to the quarterly balance dates. If details on individual members' overdue obligations were to be disclosed, the Fund should also report in a timely manner on the settlement of those obligations. If the Fund were to issue a press release when a member settled its arrears to the Fund, however, it should, in the interest of evenhandedness, also announce arrears as soon as they were six months overdue rather than wait for the release of the next quarterly financial statement. He was not advocating that approach, but was concerned that whatever approach was adopted should reflect the principle of uniformity of treatment. As for the Balance of Payments Statistics and IFS, he favored only aggregate information on overdue obligations.

The inclusion in the Annual Report of a section discussing the problem of overdue obligations and referring to the decisions taken on overdue obligations during the course of the year was called for, particularly as the Annual Report was intended to be a comprehensive report on the Executive Board's activities, Mr. Romuáldez observed. The settlement of overdue obligations by members should, however, be announced immediately.

He could support, although with some hesitancy, active publicity upon declarations of ineligibility, Mr. Romuáldez commented. The press release, along the lines of option (b) on page 6 of SM/85/12, should be issued immediately.

He supported Mr. Grosche's request for quarterly staff papers on overdue obligations to the Fund, in order to facilitate cross-country comparisons of overdue obligations and comparisons of the steps taken by the Board to deal with those overdue obligations. The inclusion of a table showing, chronologically, by member country, the amount overdue, any repayments made, and the points at which the Executive Board had taken various decisions would be useful. His concern was to ensure that when the question of a member's overdue obligations was considered by the Board no relevant information was overlooked and that all Directors had available a complete and uniform set of information on all members' overdue obligations to the Fund.

Mr. Fujino agreed that steps had to be taken to safeguard the Fund's financial position from the adverse effects of overdue obligations, which were, regrettably, increasing. Generally accepted accounting principles required that charges that remained unpaid for a certain period be excluded from net income and that provisions be established in cases of protracted overdue repurchases. Indeed, the World Bank had already shifted to non-accrual accounting for charges from members that were overdue in meeting financial obligations for six months or more. While the Fund had only limited experience with overdue obligations and their collectibility, by the time it had accumulated enough experience on the matter, it might be too late or impractical, owing to the amount of overdue obligations, to shift to nonaccrual accounting. He therefore supported a move at present to nonaccrual accounting for charges.

Based on overdue obligations alone, a shift to nonaccrual accounting would obviate the need for an increase in the reserve target, Mr. Fujino considered. The 3 percent reserve target, however, seemed rather modest relative to the recent increases in the use of Fund credit and quotas, and it should therefore be increased to reflect those changes, perhaps to about 7 percent a year.

He supported the reporting of overdue obligations in aggregate in the Annual Report, quarterly financial statements, Balance of Payments Statistics, and IFS, Mr. Fujino remarked. The staff had carried out a survey of the practices of financial institutions in 20 member countries and of international institutions regarding individual identification of borrowers in arrears. The Fund should consider whether identification of members in arrears would enhance the likelihood of repayment of obligations. On balance, he was opposed to identifying members with overdue obligations unless they were declared ineligible to use Fund resources, as such reporting might damage the relationship between the member and the Fund and reduce the chances of collecting overdue obligations in the future.

The Fund should report on declarations of ineligibility in the Annual Report and, in view of the need to ensure uniform treatment of members and to prevent leakages to the press, press releases should also be issued, Mr. Fujino considered. He proposed that the issuance of press releases be deferred until publication of the 1985 Annual Report, so that members would have advance notice that declarations of ineligibility would be made public. As to the content of the press release, he favored option (b) on page 6 of SM/85/12. Finally, he supported Mr. Grosche's request for a quarterly paper on the status of overdue obligations as long as it would not present too great a burden on the staff.

Mr. Ismael expressed his concern about the problem of overdue obligations, which was, however, a temporary phenomenon arising out of the difficulties faced by many countries experiencing the effect of one of the deepest recessions since the 1930s. The Fund should, therefore, be understanding in dealing with the problem.

The Fund should act prudently so that its financial position was not jeopardized by the negative effects of overdue obligations, although it was premature to take a decision at present on the Fund's income and reserve position, Mr. Ismael considered. While he agreed in principle that, in accordance with sound accounting practices, overdue charges of six months or more should be treated on a nonaccrual basis so as to reflect the Fund's true income and reserve position, he would prefer to delay taking a decision on that matter until the Board's annual review of the rates of charge and remuneration.

One of the principles on which the Fund was based was that the concessional nature of Fund resources should be maintained in order to encourage members to come to the Fund at an early stage of their balance of payments problems, Mr. Ismael noted. Charges had been increased

substantially in the past few years to meet the 3 percent reserve target and to cover the increasing operating costs of the institution and the costs of the higher rate of remuneration. Current Fund policy suggested that any future increases in the operating expenses of the Fund and any additional need for reserve accumulation would be reflected in the form of higher charges on the use of Fund resources. That arrangement was inequitable and burdensome for Fund debtors. He joined Mr. Jayawardena in requesting a staff paper that would examine the extent to which a more equitable distribution of the burden of the increases in the Fund's operating costs and reserve accumulation could be met partly by lowering the rate of remuneration and partly by increasing charges.

The Executive Board had already accepted the practice of reporting overdue obligations in the Fund's Annual Report in view of the need for the Fund to present a fair and accurate statement of its financial position according to generally accepted accounting principles, Mr. Ismael recalled. The question whether individual members with overdue obligations should be reported in the financial statements was still facing the Executive Board, even though the general view in previous Board discussions had been to favor aggregate reporting, partly because the Board had not been sure of the practice of other financial institutions. The results of the staff survey indicated that it was not standard practice in any institution to identify individual borrowers in arrears. The Fund was accountable, first and foremost, to its sovereign member nations, who were well informed of Fund activities. The need to inform the financial community of overdue obligations was precluded because the Fund was not a borrower in the capital markets. It would be superfluous to divulge more information than was necessary. His chair was opposed to identifying members with overdue obligations in the Fund's financial statements and could not agree to the issuance of press releases upon declarations of ineligibility.

The prime objective of the Fund, as a cooperative institution, should be to help members with overdue obligations to become current in their payments, Mr. Ismael considered. Active publicity would not ensure that members would settle their arrears to the Fund, and it could damage the relationship between the Fund and a member.

The Fund was not obliged to inform the general public or the commercial banks of decisions on ineligibility, although it did have a responsibility to inform the Fund membership, which should be done through the Executive Directors rather than through active publicity, Mr. Ismael stated. Furthermore, the staff's argument against the release of information that might be considered harmful to a member's interests or was contrary to the confidentiality of relations between the Fund and the member was also relevant in cases where a member was declared ineligible to use the Fund's resources. In sum, the prime objective of the Fund should be to recover the arrears owed to it, but active publicity regarding ineligibility was an inappropriate means of achieving that objective. He was therefore opposed to the issuance of press releases upon declarations of ineligibility. Such information, however, should be published in the Annual Report if the identity of the member was not disclosed.

Mr. Zhang indicated his broad agreement with the views expressed by Mr. Jayawardena and Mr. Kafka. He could go along with option (b) in the Chairman's statement regarding nonaccrual accounting, but he hoped that the decision on an increase in the reserve target could be postponed. He supported Mr. Jayawardena's proposal that ways should be found to ensure that the additional burden arising from a decision to increase the reserve target would be shared equitably by the borrowing and nonborrowing member countries. He favored a continuation of the present practice of reporting of overdue obligations, in aggregate, in the Annual Report and in the quarterly financial statements. Individual members with overdue obligations should not be identified in the Balance of Payments Statistics or in IFS.

He was opposed to active publicity upon a declaration of ineligibility as it was unlikely to have a positive effect, Mr. Zhang stated. The Fund should consider the matter of active publicity in the light of its overall and long-term relationship with the member countries. Following a declaration of ineligibility, the most appropriate course of action was for the Fund to try to persuade the Government involved to take the necessary action to repay its overdue obligations.

Mr. Abdallah reassured the Executive Board that all Directors representing developing countries fully recognized the need to maintain the integrity and financial strength of the Fund. They hoped that all financial assistance from the Fund to member countries would be repaid on time and that the Fund's central role in the international financial system would be strengthened. Actual or potential users of Fund resources had nothing to gain from a weak institution. It was important to recognize the fundamental principles and aims uniting all members--namely, that borrowed resources should be repaid on time and that failure to repay the Fund caused problems for the Treasurer and, eventually, for the Board. Debtor and creditor member countries differed only on how to enforce repayment and not on whether obligations should be met. He hoped that each side could understand the reasoning behind the other's viewpoint and could ultimately reach a consensus.

He fully endorsed Mr. Jayawardena's comments on the effect of overdue payments on Fund income and reserves, Mr. Abdallah stated. The question of the Fund's reserves could not be viewed only from the viewpoint of income, but should also take account of expenditure, particularly the cost of the rate of remuneration. A decision on an increase in the reserve target should be deferred until the staff paper proposed by Mr. Jayawardena had been prepared.

The staff's survey indicated that financial institutions in general did not reveal the identities of borrowers in arrears, Mr. Abdallah noted. That universal practice should be followed by the Fund, the centerpiece of the international financial system. Aggregate information only on overdue obligations should be disclosed in the Annual Report.

His chair was opposed to the issuance of a press release after a declaration of ineligibility, Mr. Abdallah commented. Disclosure of such information could have damaging consequences; publicly declaring a member ineligible to use Fund resources was tantamount to stating that the country concerned was an extremely bad credit risk or was virtually bankrupt. Commercial institutions were unlikely to become financially involved with the country in question, thereby limiting its chances for recovery. He suggested that upon a declaration of ineligibility, the Chairman immediately advise all Governors of the Fund on the action taken by the Executive Board. The Ministers would have an opportunity to exert whatever pressure they could on the member concerned.

Mr. Finaish stated that his position on the effect of overdue payments on the Fund's income and reserves was guided by four main considerations. First, he was concerned with the increasing incidence and magnitude of overdue payments, which he hoped would not erode the soundness of the Fund's financial position. Second, in taking action to preserve the Fund's financial position, an automatic approach to adjusting the income target should be avoided as it would prevent the Board from examining all relevant considerations when the target was established. Third, a decision on the reserve target should not imply any doubt about the collectibility of overdue obligations. Fourth, in principle and to the extent possible, the negative impact of overdue payments on the Fund's income should be borne, if not by those members that were in arrears, then by the Fund membership as a whole. An increase in the rate of charge penalized only users of Fund resources even though the majority of them were current in their obligations.

While he could go along in principle with a shift to nonaccrual accounting for overdue charges, he would like to know from the staff the impact of that decision on the rate of charge, Mr. Finaish stated. Given the manner in which the rates of remuneration and charges and the income target were set, it was not surprising that neither of the options in the Chairman's statement took account of the burden-sharing aspects of the proposals. He leaned toward the view expressed by other speakers that a decision on the specific mechanism and magnitude of the adjustment in the income target should be made within a broader context, including the distribution of the burden of an increase in the reserve target. Moreover, the outcome of the forthcoming discussion on penalty charges should also be taken into account.

In taking a decision on reporting by the Fund on overdue obligations Directors should keep in mind two considerations, Mr. Finaish commented. First, the credibility and financial integrity of the Fund should remain above suspicion, which required that financial statements continue to be prepared on the basis of generally accepted accounting principles. Second, any unnecessary disclosure of information in financial statements and other publications should be avoided to preserve the cooperative nature of the institution, which depended in performing its functions on the goodwill of its members.

While he agreed that the Annual Report was the most comprehensive vehicle for communicating to the public important decisions and activities of the Fund, it was not desirable to report on decisions on overdue obligations on an individual basis, Mr. Finaish remarked. Information on overdue obligations was available to all Fund members, to whom the Fund was ultimately responsible. The inclusion of decisions on overdue obligations in the Annual Report might be contrary to the principle of uniform treatment of members, as the timing of overdue payments would determine whether and when they would be identified in the Annual Report.

He favored aggregate reporting of overdue obligations in the Fund's financial statements, Mr. Finaish stated. References to individual members in the notes of those statements should be deleted. The practice of other financial institutions did not suggest the need for individual reporting, and he was not convinced that aggregate reporting would jeopardize in any way the integrity of the Fund's financial statement. Individual members with overdue obligations should not be identified in the Balance of Payments Statistics and IFS. Only those arrears that had been outstanding for more than six months should be reported.

He continued to believe that active publicity should, in principle, be avoided, Mr. Finaish remarked. Any possible positive effects of such publicity were more than offset by the negative image of the Fund that might be generated from such action: the Fund could be seen to be insensitive to the legitimate difficulties of members or as using its catalytic role to compound those difficulties. He recognized, however, that circumstances of members with overdue obligations might differ. An ad hoc approach to active publicity had certain merits, although it could lead to problems regarding the principle of uniform treatment of members. On balance, he was opposed to the issuance of press releases upon declarations of ineligibility, although he could consider, as a compromise, the inclusion of decisions on ineligibility in the Annual Report.

Mr. Salehkhoul stated that his views of the origins of overdue obligations, of the Fund's cooperative attitude toward its members, and of an equitable approach for settling overdue financial obligations to the Fund, remained unchanged from his statement at EBM/84/166 and EBM/84/185. He supported Mr. Jayawardena's position on the effect of overdue payments on Fund income and reserves. It was imperative that all member countries share the burden of an increase in expenses equally in proportion to their voting power. The staff's proposals did not reflect that view, and he joined his colleagues in requesting a study on the question of burden sharing before a decision was taken. In any case, he agreed with the staff that the Executive Board did not have enough experience with the problem of overdue obligations to the Fund and were uncertain of the results of the actions being proposed. He suggested that the Executive Board should avoid acting hastily and wait until the staff presented its study before taking a decision. In the meantime, and if the problem of overdue obligations appeared to be worsening, he was prepared to consider

appropriate measures at each annual review of the Fund's income position in the light of existing overdue obligations and other relevant circumstances.

The staff had argued that owing to the importance of the bilateral relationship between the Fund and the members, overdue financial obligations should be reported in the Annual Report, Mr. Salehkhoul noted. That argument was abstract and unconvincing. It was the principle of confidentiality within the context of cooperation that clearly represented the very essence of smooth operation of the Fund and the relationship with its members. Only principal policy decisions of the Executive Board were reported in the Annual Report; thus, reporting on overdue obligations of an individual member would be out of context. Regardless of the staff's suggested format, he disagreed with reporting of the decisions by the Executive Board on complaints with respect to members' overdue financial obligations to the Fund in its Annual Report. He strongly objected to the individual identification of members with overdue obligations in any Fund publications. It should be realized that publicizing a member's overdue financial obligations in any of the Fund's reports and/or statements would remain unamended until the next report was published. What if a member with arrears to the Fund met its obligations one day after its overdue payment had already been publicized by the Fund? That would be most detrimental to the sound relationship which should prevail between a member and the Fund.

Negative publicity against a Fund member would not preserve the integrity of the Fund or of the member concerned, Mr. Salehkhoul considered. There was no assurance that such an approach would deter other members that were likely to become overdue in their financial obligation as no member voluntarily decided to fall into arrears. According to the staff's own assessment, several members with overdue payments had exhausted all practical ways to become current with the Fund. Exogenous factors, however, had made it extremely difficult for them to achieve economic viability in the short term. He wondered how active publicity could make any difference to the ability of those countries to repay the Fund. Negative publicity would certainly complicate a member's situation when it might be formulating ways to meet its obligations. The commercial banks, the World Bank and the IDB were reluctant to identify publicly individual borrowers in arrears, let alone to issue press releases providing such information, and the Fund's approach should not be an exception to that logical and positive attitude. For the same reasons that he objected to individual reporting of members' overdue obligations in Fund publications, he was unable to accept publicity upon declaration of ineligibility which would be contradictory to the aim of maintaining a cooperative relationship between the Fund and its members.

Mr. Ortiz indicated his deep concern about the recent increase in overdue obligations. He would support those decisions that would strengthen the Fund's financial position, taking into account that any increase in expenses should be distributed proportionately among all member countries. The two options proposed by the Chairman to strengthen the Fund's financial

position had in common an increase in the reserve target, which would result in an increase in the rate of charge. Neither option seemed appropriate as they did not take into account the fact that reserves could also be increased through a decrease in the rate of remuneration. Nevertheless, if a decision had to be taken, he would favor option (b) in the Chairman's statement, which allowed for a smaller increase in the reserve target.

The Fund, given its important position in the international monetary system, should be precise in reporting information in its publications so as to maintain the respect of the international community, Mr. Ortiz remarked. The practice of other international organizations regarding reporting of overdue obligations clearly suggested the need for the Fund to maintain the principle of reporting on overdue obligations only on an aggregate basis, without identifying the individual countries concerned. Additional details could be given to official lenders, if specifically requested by the member. Private lenders could find ways to obtain more detailed information than would be available in the Annual Report.

The matter of active publicity upon declarations of ineligibility was delicate, not only for the members involved, but also for the Fund, Mr. Ortiz considered. The major objective of the present discussion, to find solutions to the problem of overdue obligations, should not be forgotten. The issuance of a press release upon a declaration of ineligibility was not the best solution for helping a member to become current in its obligations to the Fund. It was not difficult to guess what the effects of active publicity might be, despite the Fund's inexperience in that area. Private banking institutions were already cautious about the creditworthiness of potential debtors, and active publicity would certainly increase their reservations and reduce the availability of credit for those countries, which were already in the worst position to obtain additional financial resources. In conclusion, active publicity had never been thought of as a sanction against those countries with overdue obligations; it did not contribute to solving the problem and had the danger of adding an element of confrontation between members, which would be an undesirable outcome.

The Treasurer recalled that one Director had inquired about the criteria used putting a member's charges on a nonaccrual basis. More specifically, he had inquired about the treatment of a member that was overdue for six months or more in some of its payments to the Fund but not necessarily in the payment of charges. He had given the example of a member eight months overdue in settling charges, and had asked about the accounting practices applicable in the commercial world to such a case. A related question was whether the criteria to determine nonaccrual status covered only overdue payments related to the General Resources Account, or extended to overdue payments in the SDR account, or to the Trust Fund. There was no automatic or mechanical cutoff point, such as when a member was late for six months with a particular payment, that would apply in all circumstances. Rather, as with most questions of accounting practice, it was an issue that allowed for considerable judgment on the side of the

creditor. It was for that reason that the Chairman had proposed that the placement to nonaccrual status should not be automatic, but should be based on an Executive Board decision, which would allow for some discretion. For example, commercial practice permitted continued accrual even if a payment was overdue beyond the normal time period if an obligation was well secured and its settlement was expected in the near future.

An issue that would immediately arise was with respect to the treatment of charges from a member that was overdue in making repurchases for six months or more but that had remained current in paying charges as they fell due, the Treasurer remarked. It seemed unnecessary to put charges from a member on a nonaccrual basis if there were reasons to expect that payment would be made shortly. Commercial banks appeared to attach particular importance to the timely payment of interest, and, thus, they seemed to make a distinction between the payment of interest and the payment of principal, perhaps because they customarily set aside provisions to cover nonpayment or overdue payments of capital.

The Fund had so far avoided putting emphasis on fine distinctions between the categories of payments that were overdue, but there would remain questions where judgment would inevitably need to come into play, the Treasurer commented. For example, assuming the limiting case where a member that was overdue for more than six months in meeting repurchases but that always paid its charges on time--and there were in fact some members that gave preference to first paying charges--it might appear difficult not to continue accruing charges that were regularly being paid. The same argument might have less force in the case of a member that was overdue not only in discharging repurchases, but also in paying charges, even if overdue charges had not yet reached an agreed cutoff point, such as being six months overdue. In other words, it was a matter of judgment, not one to be determined by accounting principles, whether and when to place on nonaccrual basis charges from a member that was overdue for six months or more in making repurchases. In view of the many different circumstances surrounding overdue obligations, it might be best to follow some simple rule.

The effects on the Fund's income and also on charges of putting overdue charges on a nonaccrual basis were not easy to estimate, the Treasurer stated. They would depend on the type of charges to be put on a nonaccrual basis; on changes in other factors affecting the Fund's income, such as the SDR interest rate and the rate of remuneration; and on the extent of use of Fund resources. For example, in present circumstances, the effect on the Fund's income of changing to nonaccrual accounting for charges only, or for overdue repurchases as well, would be minor. On an annualized basis, nonaccrual of charges from members presently overdue for more than six months on any payment would be reflected in an increase in charges of 0.3 percent, while the increase in charges would be 0.27 percent if nonaccrual were limited to charges from members overdue for six months or more, an insignificant difference that might well be lost in rounding. The need for an increase in the rate of charge could, however, be greater in other circumstances.

A Board decision to change the reserve target could also have an impact on estimates of the effects of a change in accounting methods, the Treasurer indicated. Under the current accounting methods, the staff projected a net income of about SDR 30 million, which should be close to a net income target of 3 percent of reserves. With a change to nonaccrual accounting, but with no other changes, the Fund would have a deficit of about SDR 50 million unless the Executive Board took a decision to avoid such a deficit. The effect on the rate of charge would depend on any decisions the Executive Board would take in the light of the impact of overdue obligations on the Fund's income projected for the next financial year. Mr. Finaish's question regarding the effect of nonaccrual accounting on the Fund's income and on charges was, thus, difficult to answer in any precise way at present. For financial year 1985, nonaccrual accounting would simply result in a deficit on the Fund's income account, which would reduce the Fund's reserves. The effect on charges would depend on the conclusion reached by the Executive Board at the review of the Fund's income position in May 1985. At that time the Executive Board would consider the projections of the Fund's income for financial year 1986, including appropriate assumptions on nonaccrual accounting for charges from members overdue in payments to the Fund for six months or more. The Board would then decide on the rate of charge for the subsequent financial year, taking into account the income projections, which reflected the nonaccrual accounting of charges from overdue members.

If the Board failed to take a decision, the Treasurer went on, the matter would have to be reconsidered at the midyear review of the Fund's financial position. A projected deficit at that time, whether owing to nonaccrual accounting or to any of the other factors affecting the Fund's income, would automatically result in an increase in the rate of charge sufficient to achieve the net income target under the safeguard clause, unless the Board was able to agree otherwise with the necessary qualified majority.

As to the question of circulating a quarterly report on overdue obligations to Executive Directors, the Treasurer pointed out that the staff already prepared a number of reports although they might not completely answer all Directors' questions. He suggested that Directors should wait until the second six-monthly report on overdue obligations to determine whether the tabulation in that report should be reproduced on a quarterly basis.

It would be difficult to prepare a paper on the burden-sharing aspect of any measures the Board might take to safeguard the Fund's financial position against overdue obligations, the Treasurer concluded. Questions of equity were determined not only by a set of principles, but also by perceived interests. The staff would prepare such a paper, however, if the Board wished.

The staff representative from the Treasurer's Department recalled that one Director had inquired about the accounting principles regarding nonaccrual that would guide commercial enterprises that encountered delays

in the repayment of principal but not in the payment of interest. A full answer to that question was somewhat complicated. Accounting principles would clearly differentiate between the two types of payments. Nonaccrual accounting would be called for if interest payments were delayed beyond the stated period, while the risk of nonpayment of principal would be covered by provisions set up for that purpose, the amount of provisioning depending on the judgment of the lender regarding the probability that the loan would eventually be repaid in full or in part. If a creditor fell behind in payments of principal but continued to pay interest on time, accounting principles would not prevent the lender from continuing to accrue interest. When interest also fell overdue, the judgment of the lender whether or not to continue accruing might, of course, be influenced by the experience regarding the payment of principal.

In the United States those accounting principles were supplemented by the regulations of the Security and Exchange Commission, which governed reporting requirements of companies issuing securities in the U.S. market, and by the regulations of the Banking Supervisory Authorities, the staff representative remarked. Those authorities prescribed that overdue payments of principal or interest should be considered as nonperforming loans and should no longer be accrued unless they were sufficiently collateralized and in the process of being collected. Accounting principles left some room for judgment in certain situations.

Mr. Grosche said that in preparing the paper on burden sharing, the staff should take into consideration the reduction in the value, both in nominal and in liquid terms, of the creditors' positions in the Fund owing to overdue obligations. An increase in the reserve target would be one way to deal with that problem. The target had been considered by a number of Directors to be insufficient even before the emergence of overdue obligations. He suggested that the staff should prepare a study on the appropriateness of the current reserve target.

Mr. Dallara stated that he was surprised by the view of a number of Directors that creditors had failed to shoulder an appropriate share of the burden of the Fund's operational costs and reserve accumulation. There were many ways to measure the costs, apart from the narrow definition of foregone income, including the borrowing necessary for many creditor members to provide resources to the Fund. He was also concerned about the definitive demarcations drawn by a number of Directors of creditor and debtor member countries. The cooperative nature of the Fund, a term used by many Directors at the present meeting, was reflected in the fact that most member countries had been both creditors and debtors to the Fund. The idea that there was a permanent division between creditors and debtors was bothersome.

Mr. Leonard reiterated that his chair was not opposed, in principle, to raising the level of reserves, but the question of raising the reserve target should not turn simply on the question of overdue obligations to

the Fund. Other factors should also be taken into consideration. The most appropriate time for taking a decision on a reserve target increase would be on the occasion of the review of the Fund's income position.

Mr. Wicks inquired which country had borrowed most from the Fund. A decision to strengthen the Fund's financial position should not be delayed further. A staff paper on the various issues raised by Directors would not solve the problem of overdue obligations.

Mr. Kafka agreed with previous speakers that it was wrong to view the Fund as being made up of a group of permanent debtors and a group of permanent creditors.

Mr. Tornetta pointed out that if the reserve target were increased, the rate of charge would be higher with a shift to nonaccrual accounting for charges than otherwise. If the overdue obligations were eventually paid, however, the rate of charge could be reduced, and the burden on the debtors would therefore be lifted somewhat.

The Treasurer agreed that, assuming the reserve target remained at 3 percent and assuming a shift to nonaccrual accounting, an increase in the rate of charge might eventually be triggered as a result of increasing overdue obligations. However, the effects of nonaccrual accounting could not be isolated from the effects of a reserve target increase. Furthermore, Mr. Tornetta's argument would apply only if the increase or reduction in the rate of charge was instantaneous.

Mr. Jayawardena stated that he recognized that the study he had proposed would be a difficult exercise, but so were many others, including, for example, the world economic outlook. He had suggested a study on burden sharing because as the rate of remuneration increased to 100 percent of the SDR rate, expenditure increased each year, and overdue obligations were rising, the burden was being borne by those members that were using Fund resources to support their adjustment efforts. He agreed that there were no permanent creditors or debtors in the Fund. The appropriate rate of charge could be considered on an annual basis as provided for in Rule I-6(4)(a).

Mr. Nimatallah observed that Mr. Jayawardena was referring to three categories of Fund members: borrowers that did not settle their obligations to the Fund; borrowers that remained current in their payments to the Fund; and nonborrowers.

Mr. Dallara stated that it would be difficult to view the concept of burden sharing in a narrow framework, particularly in terms of income foregone, based on interest rate differentials between the rate of remuneration and the SDR rate. The staff should perhaps look at the potential burden associated with the enlarged access policies and prolonged use of Fund resources.

Mr. Nimatallah suggested that the staff prepare a joint paper on the question of burden sharing and on the adequacy of the Fund's reserves.

The Chairman noted that the question of active publicity had divided the Board in a fashion that was unusually pronounced. Ten Executive Directors, representing some 59 percent of the voting power, were in favor of the issuance of a press release upon declarations of ineligibility. Of that group of Directors, some were in favor of issuing a press release immediately following a Board decision on ineligibility, while others favored a delay of between two weeks and one month so that the country concerned might have an opportunity to repay the overdue obligations. Twelve Executive Directors, representing some 40 percent of the voting power, were adamantly opposed to active publicity. As the split in the Board on the question of active publicity was very pronounced, and as it entailed an element of judgment and had an impact on the relationship between the Fund and member countries, he asked Executive Directors to give further thought to whether or not the Fund should issue a press release upon declarations of ineligibility. If there were strong objections to delaying a decision on that matter, he would draw a consensus.

Mr. Wicks stated that he was not clear about the need for a delay in taking a decision on active publicity, as Directors representing 59 percent of the voting power were in favor of such publicity. Could the Chairman elaborate on the split between those who were in favor of immediate publicity and those who were in favor of the issuance of a press release after a delay? What were the considerations that the Chairman wished the Executive Directors to think about?

The Chairman remarked that active publicity was an issue that would put the Fund in the limelight. While there were obviously strong arguments in favor of active publicity, he felt that as Directors were not absolutely certain on the modality of a press release, further thought should be given to the question.

Mr. Dallara stated that he recognized the concerns expressed by the Chairman, particularly regarding the split between those supporting publication at the time of a declaration of ineligibility and those favoring publication after some delay. He also recognized the need for the Executive Board to reflect on those matters, but he recalled that the question of active publicity had been discussed at EBM/84/185 and EBM/84/186 (12/17/84), when the Executive Board had requested a further staff paper, which had been prepared and was being considered at the present meeting. He would be particularly worried if the Executive Board were unable to reach a decision on two of the four issues before it: the questions of the reserve target, nonaccrual accounting, reporting of overdue obligations in Fund documents, and publicity upon declarations of ineligibility.

His authorities were especially concerned about the need for a reserve increase, not only because of the rise in overdue obligations, but also because of the deterioration of reserves relative to other key variables, Mr. Dallara indicated. The urgent need for a reserve increase

had grown between October and January, as indicated by the various formulas presented in Table 2, Attachment III to EBS/85/32. Any delay in dealing with overdue obligations would only limit the Executive Board's options in the future. More specifically, on the question of active publicity, he would be prepared to go along with a delay in the issuance of a press release following a declaration of ineligibility if that were the consensus of the Board.

Mr. Kafka agreed with the Chairman that, given the unusual split in the Executive Board regarding the question of active publicity, a decision on that issue should be delayed. It would be unwise to polarize the views of the Executive Board rather than reach a consensus on the issue.

The Chairman observed that the Executive Board had taken an important decision at the present meeting by favoring a shift to nonaccrual accounting for charges.

The Treasurer, responding to a question from Mr. Leonard, stated that the Executive Board would review the Fund's income position for financial years 1985 and 1986 in May, at which time it could also consider a staff paper on factors relating to Fund reserves and to burden sharing.

Mr. Fujino said that he agreed with the Chairman that an important decision had been taken to change to nonaccrual accounting for charges. His authorities were in favor of a large, rather than a modest, increase in the reserve target. Furthermore, they considered it necessary to study the need for a reserve target increase in detail, for Board discussion at a later date. Finally, he suggested that action to issue press releases on declarations of ineligibility should begin only after publication of the 1985 Annual Report.

The Chairman pointed out that Mr. Fujino's position on active publicity made the identification of a majority in favor of an immediate decision particularly difficult.

Mr. Grosche supported the Chairman's suggestion for considering further the question of active publicity.

Mr. Nimatallah observed that it was unlikely that Executive Directors would change their position on active publicity, which was a matter of judgment. One group of Directors considered that active publicity would harm members that were declared ineligible to use Fund resources, thereby limiting their ability to repay the Fund. Those Directors in favor of active publicity considered that such action was likely to deter countries from becoming overdue in their payments to the Fund. Both groups of Directors had the common objective of improving the Fund's financial position.

A number of Directors had expressed concern about the high rate of charge that would be necessitated by a move to nonaccrual accounting and by a reserve target increase and had urged that the burden of overdue

obligations and rising administrative costs of the Fund be borne by both borrowing and nonborrowing member countries, Mr. Nimatallah recalled. He urged those Directors to consider imposing more meaningful sanctions against countries with overdue obligations. A declaration of ineligibility did not, in effect, change a member's status, since it already could not make use of Fund resources or enter into an arrangement with the Fund. Why should borrowing members without overdue obligations suffer because a number of members did not repay the Fund on time? More meaningful sanctions to discourage overdue obligations should be introduced.

Mr. Wicks indicated his agreement with Mr. Nimatallah. He recalled that at EBM/84/185 and EBM/84/186 a number of Directors had been in favor of taking a decision on active publicity. He had supported other Directors who had requested that the staff paper on that issue currently being considered by the Board be prepared (SM/85/12). He was in favor of issuance of a press release immediately following a declaration of ineligibility in order to limit the chances of such information leaking to the press. He could, however, with some reluctance, agree to delay publication of a declaration of ineligibility for two weeks following the Board's decision, on a trial basis.

Mr. Nebbia stated that those Directors in opposition to the issuance of a press release were concerned about the results of such publicity, which might, in fact, alienate members from the Fund. He agreed with Mr. Kafka that the Executive Board, which was unusually split on the question of active publicity, should reach a consensus on that issue at a later date.

The Secretary, responding to a question from Mr. Dallara, stated that 11 Directors, representing about 63 percent of the voting power, had indicated their willingness to accept an increase in the reserve target.

Mr. Dallara noted that the qualified majority necessary to take a decision on an increase in the reserve target had almost been met. He wondered if those Directors who considered that the question of publicity required further reflection might support a reserve increase in principle, leaving aside the question of burden sharing?

The Chairman stated that five of the Directors had indicated an open mind or even agreement to go along with option (b) in his opening statement, proposing a shift to nonaccrual accounting and a moderate increase in reserves. The 11 Directors identified by the Secretary as being in favor of an increase in the reserve target did not include the afore-mentioned five Directors because it was not clear whether they favored an increase in the reserve target as well as the shift to nonaccrual accounting.

Mr. Dallara indicated that if the Board were prepared to go along in principle with an increase in reserves, after the modalities of burden sharing had been worked out, he was certainly prepared to reflect one more time on the question of active publicity.

Mr. Kafka inquired about the positions of Directors regarding individual or aggregate reporting of members with overdue obligations in the Annual Report.

The Chairman asked Directors to indicate whether they were in favor of individual or aggregate reporting of decisions on ineligibility in the Annual Report.

Messrs. Ismael, Kafka, Nebbia, Salehkhoul, Zhang indicated their opposition to identification of members that were declared ineligible to use Fund resources in the Annual Report, as did Messrs. Abdallah, Jayawardena, Ortiz, and Toé.

Messrs. Dallara, Fujino, Grosche, Nimatallah were in favor of identifying individually those members that were declared ineligible to use Fund resources in the Annual Report, as were Messrs. Blandin, Fugmann, Leonard, Romuáldez, Schneider, Wijnholds, and Tornetta.

Mr. Finaish stated that if the Board decided against issuing a press release upon declarations of ineligibility, he could go along with identifying members individually in the Annual Report.

The Director of the Legal Department, responding to a question from Mr. Jayawardena, stated that a decision to move to nonaccrual accounting for charges required a simple majority. A decision to increase the reserve target would require a qualified majority of 70 percent of Directors' votes. If, after the midyear review of the Fund's income position, there were a shortfall of at least 2 percent from the reserve target and there were no agreement by the Board by December 15 to deal with the situation, the rate of charge would increase automatically.

The Chairman made the following summing up:

Executive Directors stressed the seriousness of the problem of overdue obligations and the need to protect the financial position of the Fund. There remain, however, differences of view regarding some of the main issues under consideration today.

1. Effect of overdue payments on Fund income and reserves

The sense of the meeting was to accept the practice of nonaccrual accounting for overdue charges. Ten Directors, representing 61 percent of the voting power, favored nonaccrual accounting for charges from members that are late for six months or more in meeting financial obligations to the Fund. Five other Directors indicated that they could go along in principle with, or were not opposed to, option (b) in my opening statement (Buff Document 85/47) proposing nonaccrual accounting combined with a smaller increase in reserves than would be necessary without a move to nonaccrual accounting, but noted that their final position would be conditional upon examination of burden

sharing in the Fund. The staff will spell out the operational details and financial aspects of the Board's decision to move to nonaccrual accounting for charges from members overdue for six months or more in settling financial obligations to the Fund in the forthcoming paper reviewing the Fund's financial position.

On the question of reserves, the 70 percent majority required to increase the target amount of net income for the year of 3 percent was not obtained. Eleven Directors, representing 63 percent of the voting power, supported an increase in the Fund's reserve target. While a number of those Directors preferred a smaller increase of the reserve target than the increase to 6 percent suggested by the staff, others favored a higher target in the range of 6-8 percent. It must be pointed out that the 11 Directors referred to above do not include those 5 Directors who, as already noted, have indicated their willingness to consider further option (b) in my statement, which includes an increase in the reserve target.

A number of Executive Directors expressed interest in an examination of the factors relevant for a judgment of the adequacy of the Fund's reserves, and other Directors requested a consideration of the sharing of burdens among member countries in the Fund. The staff will prepare a paper to serve as the basis for Executive Board consideration of these issues.

2. Reporting by the Fund of overdue obligations

Directors agreed that aggregate information on overdue financial obligations would be included in the Annual Report, the quarterly Financial Statements of the General Department and the SDR Department, Balance of Payments Statistics, and International Financial Statistics. Seventeen Directors, representing almost 60 percent of the voting power, were opposed to identification of members with overdue obligations in Fund publications. The Board also decided that when members were declared ineligible to use Fund resources they would be identified individually in the Annual Report.

3. Publicity upon a declaration of ineligibility

The question of the issuance of a press release upon a declaration of ineligibility has divided the Board in a fashion that was unusually pronounced. Ten Executive Directors, representing a majority of the voting power, were in favor of a press announcement by the Fund when a member was declared ineligible to use Fund resources. Most of those Directors were in favor of immediate publication upon a declaration of ineligibility, while the remainder supported a delay in publication of between two weeks and one month. One of these Directors, while supporting

the issuance of press releases on declaration of ineligibility, considered that it would be appropriate to give members sufficient warning that such publicity would take place. He suggested that action to issue press releases on declarations of ineligibility should begin only after publication of the 1985 Annual Report. Twelve Executive Directors were adamantly opposed to active publicity.

After some discussion, in view of the clear tendency today toward an increase in the reserve target and given the open-minded attitude of a number of Directors on that question, it was agreed that Directors would reflect one more time on the issue of active publicity.

It was agreed that, in the first half of May--when the Executive Board would review the Fund's income position for financial years 1985 and 1986--the question of the adequacy of the Fund's reserves and of the burden sharing among members arising from overdue obligations would be considered on the basis of a new paper prepared by the staff which would discuss the elements bearing on these issues. On that occasion, Directors would also come to a firm view on the kind of publicity they might wish to give to declarations of ineligibility. A staff paper on the subject of special charges on overdue obligations would be brought to the agenda at an early date.

The Executive Board then took the following decisions:

Accounting for Charges from Members with Overdue Obligations

The Executive Board decides that henceforth charges on the use of Fund resources from members that are overdue in meeting financial obligations for six months or more will not be included in accrued income unless a member, though overdue in other obligations to the Fund, has remained current in settling charges as they fall due. Charges that are not included in accrued income will instead be reported as Deferred Income.

Decision No. 7930-(85/41), adopted
March 13, 1985

Reporting by the Fund of Overdue Obligations

The Executive Board decides that overdue financial obligations to the Fund of members having obligations overdue for six months or more will be reported in aggregate by category of obligation but without identifying the members involved, in the Fund's Annual Report, quarterly Financial Statements of the

General Department and the SDR Department, yearbook issue of Balance of Payments Statistics, and International Financial Statistics.

Declarations of ineligibility to use the Fund's general resources will be reported in the Fund's Annual Report and will identify the members concerned, beginning with the 1985 Annual Report.

Decision No. 7931-(85/41), adopted
March 13, 1985

DECISION TAKEN SINCE PREVIOUS BOARD MEETING

The following decision was adopted by the Executive Board without meeting in the period between EBM/85/40 (3/13/85) and EBM/85/41 (3/13/85).

2. ISLAMIC BANKING - STAFF VISIT TO PAKISTAN

The Executive Board approves staff travel to Pakistan to explore the implications of the Islamization of the banking system in a Muslim member country as set forth in EBD/85/73 (3/11/85).

Adopted March 13, 1985

APPROVED: January 2, 1986

LEO VAN HOUTVEN
Secretary

Statement by the Managing Director on
Overdue Obligations to the Fund
Executive Board Meeting
March 13, 1985

On March 13, 1985, Executive Directors will consider three issues arising from the Fund's experience with overdue financial obligations. The first concerns the effects of overdue obligations on the Fund's income and reserves and steps to strengthen the Fund's financial position in light of overdue payments. The second concerns the reporting by the Fund, in its annual reports, financial statements and regular statistical publications, of information on overdue obligations to the Fund. The third is the question whether, beyond such factual and statistical reporting as may be appropriate, the Fund should engage in "active publicity" by issuing a press release upon or soon after a declaration of a member's ineligibility to use the Fund's general resources.

All of these issues have already been the subject of considerable discussion in the Board. Supplementary information on the first two topics, requested by the Board at its meeting on December 17, 1984, is provided in EBS/85/32, dated February 5, 1985. As also requested by the Board at the December 17 meeting, the staff has prepared a short separate paper (SM/85/12, 1/9/85) on the question of publicity upon a declaration of ineligibility. The issues, while related in that they all derive from the problem of overdue obligations to the Fund, are separable, and I would suggest that a separate treatment of them in the discussion on March 13 would serve the interests of clarity. In an effort to facilitate the Board's further consideration of these issues, the following paragraphs outline some main points Directors may wish to bear in mind, in particular on the effect of overdue payments on the Fund's income and reserves.

1. Effect of overdue payments on Fund income and reserves

In the Board's earlier discussion of this subject, it was generally appreciated that the incidence and growth of overdue payments have negative effects on the Fund's financial position and standing and that, while these effects may be difficult to assess with precision, it would be prudent that action in some form be taken to strengthen the Fund's financial position in the presence of sizable overdue payments. Two general approaches have attracted the most attention: steps to increase the rate of accretion of the Fund's reserves, either guided by formulas relating the reserve increase to relevant variables, or decided on an ad hoc basis; and the nonaccrual of charges due from members having protracted arrears, together with some accretion of reserves in light of overdue repurchase obligations. Executive Directors will recall that a number of variants on the former course had been suggested for consideration by the staff in EBS/84/231 (11/14/84), and further information requested by Directors, relating primarily to possible guiding formulas, is provided in EBS/85/32. The possibility of not accruing overdue charges in certain circumstances

was also suggested by some Directors during the course of the meeting on December 17. In response to further questions, this possibility is also discussed in further detail in the supplementary notes in EBS/85/32.

In examining the alternative approaches, several points common to them may be noted. (a) The issue at hand is to decide on steps that would better secure the financial position of the Fund in circumstances of overdue payments. A further step which also might be thought to encourage members directly to discharge their overdue obligations would be to impose special charges on such obligations. This will be discussed in a paper to be issued separately. (b) Whatever course is chosen, a strengthening of the Fund's finances implies raising charges somewhat above levels that would otherwise prevail--that is, of raising charges or of moderating reductions that might otherwise have taken place. (c) It does not seem possible, however, to predict with certainty the quantitative effect of any of the techniques on charges or on their variability, and the effects of any of the techniques may well be overwhelmed by other factors determining the Fund's income. (d) Many Directors have shown some reservations toward exclusively automatic formulas, whether they would operate to increase the Fund's reserves or to deduct certain amounts from the Fund's accrued income.

In this light, Directors may now wish to come to a decision on a technique that would lie between automaticity and reliance on fully ad hoc decisions. The following two options may provide a helpful basis for deciding on an approach in this middle range.

a. An agreed increase of the reserve target by some minimum amount, which would continue so long as overdue obligations having a duration of six months or more are outstanding. It would be understood that further increases could be decided if there were further deterioration in the situation on overdue obligations, and the results of the various formulas could be taken into account in considering such decisions. A minimum increase of the targeted reserve growth from 3 percent to on the order of, say, 6 percent--which would raise the income target by about SDR 30 million--would be broadly consistent with the results of several of the formulas illustrated and would seem to be indicated in present circumstances.

b. A presumption that unpaid charges would be placed in nonaccrual status after a certain period of nonpayment of charges by a member, such action to be taken on a lapse of time basis, but such action to be deferred if in management's judgment payment is imminent or other strong reasons justify deferral. If this course were favored, it would be for consideration that a period of nonpayment of charges of six months be selected as the presumptive "trigger" for decisions on nonaccrual. A somewhat smaller increase of the reserve target, in light of overdue repurchases, would be consistent with this option.

I believe we should try to resolve this issue on the basis of these options which, of course, partly overlap. The staff will prepare specific amendments to Rule I-6(4) in light of the Board's decision, for adoption by the Board at an early date.

2. Reporting by the Fund on overdue obligations

The Executive Board will consider a number of questions relating to the reporting by the Fund in published documents on the matter of overdue obligations. The question of such reporting arises in connection with the Fund's Annual Report, the quarterly financial statements, Balance of Payments Statistics, and International Financial Statistics.

With respect to the Annual Report, the staff has proposed that decisions by the Executive Board on complaints with respect to members' overdue obligations be reported in the Annual Report. This is, of course, the most comprehensive vehicle for the communication to the public of important decisions and activities by the Fund, and publication of this kind would be in line with past practice. I have sensed little, if any, objection to the staff's proposals in this respect.

The issue in relation to the other three publications is essentially that of the identification of members in arrears to the Fund. With respect to the financial statements, the general view in earlier discussions was that reporting in aggregated form would be appropriate and consistent with the Fund's standards. Before deciding the further issue of identifying the names and amounts involved for individual members, however, Directors wished to have supplementary information on the practices of other institutions. That information has been supplied in EBS/85/32. While its relevance to the Fund's practices may not be conclusive, it does not point to individualized reporting. If such individualized reporting is not favored by the Board, the Board might wish to consider whether to delete references currently made to individual members in the notes to the financial statements.

It is suggested that the matter of identification of members in arrears to the Fund in Balance of Payments Statistics be guided by the decision on this issue with respect to the financial statements. It is proposed not to modify the presentations of Fund Accounts and Monetary Accounts in IFS so as to identify members' overdue obligations to the Fund.

3. Publicity upon a declaration of ineligibility

SM/85/12 presents some relevant history and discusses considerations bearing on the issue whether the Fund should engage in what Directors have called "active publicity" in relation to declarations of ineligibility, by issuing a press release upon or shortly after such declarations. In my judgment, the Board's decision should be guided primarily by whether such active publicity is judged likely to be of positive benefit to the

Fund in dealing with the problem of overdue obligations. Another consideration is whether in the absence of such releases there would be a significant risk of premature and partial disclosure which the Fund should feel compelled to avoid. Partly related to both of these considerations is the question whether, if issuance of press releases is favored, it would be desirable to provide for some delay following a declaration of ineligibility. In any event, Directors will wish to weigh these different considerations in the light of the overall relationship between the Fund and member countries.