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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 90/24

10:00 a.m., February 23, 1990

M. Camdessus, Chairman

Executive Directors	Alternate Executive Directors
G. K. Arora	L. E. N. Fernando
	C. Enoch
C. S. Clark	Zhang Z.
T. C. Dawson	
J. de Groote	
E. T. El Kogali	
E. A. Evans	S.-W. Kwon
E. V. Feldman	R. J. Lombardo
L. Filardo	M. A. Fernández Ordóñez
R. Filosa	
M. Finaish	
M. Fogelholm	I. H. Thorláksson
	O. Kabbaj
G. Grosche	
J. E. Ismael	T. Sirivedhin
A. Kafka	L. M. Piantini
J.-P. Landau	J.-F. Cirelli
Mawakani Samba	C. V. Santos
Y. A. Nimatallah	M. Al-Jasser
G. A. Posthumus	G. P. J. Hogeweg
K. Yamazaki	S. Yoshikuni

L. Van Houtven, Secretary and Counsellor
S. L. Yeager, Assistant

Also Present

IBRD: M. de Nevers, Risk Management and Financial Policy Department. African Department: R. C. Williams. Asian Department: M. W. Bell. Exchange and Trade Relations Department: L. A. Whittome, Counsellor and Director; T. Leddy, Deputy Director; G. R. Kincaid, M. V. Shadman. External Relations Department: E. Ray. Legal Department: F. Gianviti, General Counsel; W. E. Holder, Deputy General Counsel; R. H. Munzberg, Deputy General Counsel; T. M. C. Asser, A. O. Liuksila. Middle Eastern Department: P. Chabrier, Deputy Director. Research Department: P. Isard, S. Takagi. Secretary's Department: A. Tahari. Treasurer's Department: D. Williams, Deputy Treasurer; J. E. Blalock, D. Gupta, B. E. Keuppens, O. Roncesvalles, G. Wittich. Western Hemisphere Department: S. T. Beza, Counsellor and Director. Office in Europe: J. K. Rosenblatt. Office of the Managing Director: A. K. Sengupta, Special Advisor to the Managing Director; E. A. Milne. Personal Assistant to the Managing Director: H. G. O. Simpson. Advisors to Executive Directors: N. Adachi, M. B. Chatah, Z. Iqbal, J. M. Jones, K.-H. Kleine, P. O. Montórfano, B. S. Newman, P. Péterfalvy, D. Powell, F. A. Quirós, A. Raza, S. P. Shrestha. Assistants to Executive Directors: G. Bindley-Taylor, B. A. Christiansen, E. C. Demaestri, S. K. Fayyad, B. R. Fuleihan, M. A. Ghavam, S. Gurumurthi, M. Hepp, J. Heywood, L. Hubloue, A. Iljas, C. Y. Legg, S. Rouai, D. Saha, J.-P. Schoder, Shao Z., J. C. Westerweel, Yang J.

1. OVERDUE FINANCIAL OBLIGATIONS - STRENGTHENED COOPERATIVE STRATEGY - FURTHER CONSIDERATIONS

The Executive Directors considered the following statement by the Managing Director on further considerations relating to the strengthened cooperative strategy for dealing with overdue financial obligations to the Fund:

> Drawing on our recent informal discussions, I would like to set out succinctly some key elements of a possible approach that could benefit from further discussion and also respond to questions raised about the desirability of establishing a further special contingent account. I will also comment briefly on the financial consequences of compulsory withdrawal; a note on legal aspects of this matter has been circulated to Executive Directors. 1/
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> The following comments focus on the ways open of assisting a cooperating member to remain current with the Fund during a Fund-monitored program, and to clear arrears following satisfactory performance under such a program. I will not in these brief remarks try to deal with the many details that would have to be tackled either in general decisions or specific application; nor repeat the many caveats regarding overall framework, moral hazard, and limitations that have been referred to in my earlier statements and have been emphasized by Directors.
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> In particular, I have taken into account the emphasis which Directors have placed on the need for a certain pragmatism within the scope of our basic principles in dealing with the problem of arrears of these 11 countries. The economic circumstances and immediate prospects of these countries differ very widely from one to the other, and we need to be prepared to tailor our approach to best help these countries undertake and sustain a fundamental change in their economic policies.
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> 1. Financing during the period of a Fund-monitored program
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> It seems widely held that it should be left to the member to meet obligations falling due to the Fund during a Fund-monitored program, with the assistance of support groups, consultative groups, and the international community. The importance attached to this point by major creditor members, and their strong expressions of confidence that it is feasible, must be taken to provide a sound basis on which to proceed. At the same time, ways to strengthen the effectiveness of support groups will need to be pursued actively in general terms and in individual cases.

1/ Reproduced in Annex.

Among the specific financing proposals before Executive Directors, Mr. Arora's proposal has created strong interest as a possible reinforcement of the efforts of support groups.

I would suggest that we consider the following approach:

a. Members projected to contribute less than, say, 1 percent of new quota under burden sharing--and taking into account differences in members' unremunerated positions--would be invited to contribute the difference to an administered account in the form of loans at zero interest.

b. The proceeds of these contributions would be on-lent by the account to cooperating arrears countries, in close coordination with the support group and, as necessary, to supplement its efforts. In particular, these resources would be used to assist the country in meeting regular charges on obligations in the General Resources Account falling due to the Fund during the Fund-monitored program.

c. To the extent that this mechanism resulted in settlement by those countries of charges that would not otherwise have been paid, it would, pari passu, reduce demands on the mechanism for burden sharing of deferred charges during the period of Fund-monitored programs.

d. Voluntary contributions to the account would be repaid--together with any net earnings accrued by the account--in line with repayments to the account by the beneficiary arrears countries.

2. <u>Financing following successful completion of a Fund-monitored program</u>

In our earlier discussions, it had been suggested that the Fund be prepared, under a special policy, to provide an outright disbursement from the General Resources Account, following successful completion of a Fund-monitored program and the clearance of arrears, up to the equivalent of arrears outstanding at the beginning of the program. Although it was proposed that agreement on a successor program involving upper credit tranche conditionality also be a requirement for such disbursements, it was left open whether such a successor program would involve a further use of Fund resources.

While generally endorsing the concept of the rights approach, Executive Directors have expressed a number of reservations and have put forward suggestions about the specific modalities proposed. Some have felt that we should not appear to exclude some form of use of the resources of the structural adjustment and enhanced structural adjustment facilities from the suggested financing.

These concerns and proposals have substance and suggest that, while retaining the essence of "rights," we should follow an approach to financing under the rights approach that is more eclectic and better tailored to the circumstances and merits of each particular case. I wold suggest the following as the main outline of an alternative approach:

a. Performance under a Fund-monitored program would be a sine qua non for the accumulation and eventual exercise of rights.

b. A further condition for the exercise of rights would be approval of a subsequent Fund arrangement involving upper credit tranche conditionality, following clearance of arrears. This arrangement would entail a use of Fund resources on an appropriate scale.

c. Whether resources of the General Resources Account--and in particular the extended Fund facility, the structural adjustment facility, or, exceptionally, the enhanced structural adjustment facility--or some combination--would be used, would be determined by the Executive Board in light of all relevant factors--including, for example, the strength of the country's performance under the Fund-monitored program; the strength of its successor program; the importance of structural elements of the program; the prospects for viability and the potential importance of concessional terms; and the attitude of members and other institutions toward continued and, at the least, equally concessional support for the member in the circumstances.

If this approach were favored, I would suggest that it be accompanied and defined by a policy statement by the Executive Board, possibly endorsed by the Interim Committee, making clear that the general approach was intended to be limited only to the members now in protracted arrears and, of them, only to those that are prepared to cooperate and enter into a Fund-monitored program before the end of 1990. Such a declaration could provide a method of insulating these cases for which some recourse to the exceptional provisions on access and phasing may be necessary.

I believe these suggestions reflect the main direction of Directors' views on these key aspects of the problem, and I think that in most of the cases they would suffice to solve the problems with which we are confronted, provided always that the country in arrears fully cooperates with the Fund.

A number of other important points and suggestions have also been made by Executive Directors which could help if not generally then in particular cases. Here I would list only a few of those that I have noted.

There is the suggestion that while in some cases we would insist that the collaborating member be held responsible for keeping current on both charges and repurchases falling due during the early part of a Fund-monitored program with help from the support group, we could envisage, once a certain track record had been established, a use of other sources of finance--such as the Special Disbursement Account--to assist in meeting that part of the charges falling due that could not be financed by other means. Also, I have noted the suggestion of several Executive Directors that we should keep in mind Mr. Posthumus's suggestions for a periodic conversion or "deaccumulation" of arrears. Apart from some technical advantages, this might, in some cases, offer an overt recognition of good performance under a monitored program, which could contribute to maintaining the required domestic support for that program.

I note also the important proposal that in some cases in the context of a Fund-monitored program it could be important to ensure that there is a gradual buildup of budgetary resources--by definition in local currency, and deposited in a special account in the central bank--to ensure that the Government is in a position to purchase the foreign exchange necessary to meet obligations to the Fund. In a similar vein, there is the suggestion that we should make more use of escrow accounts to accumulate the foreign exchange that will be required to meet obligations to the Fund on time.

I have not put forward the above with the intention of it providing a basis for a strengthened arrears strategy but as a response to the many helpful comments and suggestions by Executive Directors. But if Executive Directors so wished, the considerations advanced in this statement, together with those put forward in my statement of February 20 (EBM/90/20, 2/20/90), could provide such a basis.

3. Establishment of a further special contingent account

I have proposed the establishment of a further special contingent account (SCA-2) to strengthen the General Resources Account and to provide "backing" for the disbursements that could be called for under the rights approach. The SCA-2 would be funded under the same principles as the present burden-sharing mechanism, with the rate of remuneration reduced to 80 percent of the SDR interest rate and charges increased to generate half the amount of resources raised from lowering the rate of remuneration to 80 percent of the SDR rate. Amounts would be refunded to contributors as repurchases under the rights approach were made.

This approach envisages that deferred income would continue to be funded under the burden-sharing mechanism as long as charges remained overdue six months or more. Mr. Grosche has suggested, however, that it might be preferable that the resources accruing to the present Special Contingent Account, which are equivalent to 5 percent of reserves at the beginning of the Fund's financial year--amounting to approximately SDR 66 million per annum--might in the future flow instead to the proposed new account. There are arguments of simplicity of presentation in favor of such a course, and it would help build up balances to back the rights approach.

Resources presently held in the Special Contingent Account amount to approximately SDR 195 million, and any amounts remaining in that account would be refunded to creditors and debtors in proportion to their contributions when there were not overdue obligations or at such earlier time as the Executive Board might determine. There seem also to be reasonable arguments, at least for a period of time after the establishment of the SCA-2, to continue adding to the existing Special Contingent Account. The existence of two accounts, with the SCA-2 providing backing for the rights approach, would seem to give the Fund added protection in relation to overdue obligations until the rights approach was more firmly established. In particular, the present Special Contingent Account would continue to protect the Fund in relation to existing arrears from members that may not adopt Fund-monitored programs. As members availed themselves of Fund-monitored programs in connection with the rights approach, and the total of overdue obligations stabilized or fell, then consideration could be given to reducing the amounts presently added to the Special Contingent Account. In such circumstances, these resources would then also flow to SCA-2, though at a somewhat lower rate than would otherwise have accrued to the present Special Contingent Account, as backing to the rights approach as long as the proposed burden-sharing arrangements were in effect. The SCA-2 could also be enabled from the outset to provide protection against any existing overdue obligations.

This matter need not be decided now, and we could return to it on the occasion of our review of burden sharing and the Fund's income position.

4. Financial consequences of compulsory withdrawal

The financial impact on the Fund's financial position of a member's withdrawal from the Fund depends on whether the accounts with the withdrawing member would be fully settled in accordance with the procedures provided for in the Articles. If the procedures would be fully adhered to, there would be no adverse impact on the Fund's financial position, apart from some liquidity effect. It should be noted that there were no adverse effects in respect to the four cases of withdrawal in the Fund's history--Poland in 1950, Czechoslovakia in 1954, Cuba in 1964, and Indonesia in 1965; of these, Czechoslovakia was the only case of compulsory withdrawal.

The possibility exists, however, that no agreement would be reached on a settlement of the member's liabilities to the Fund at the time of its withdrawal, or that an agreement that had been reached was not observed. In such circumstances, the Fund would need to make a judgment whether it is probable that part or all of its claims on the member would not be realized--namely, whether a loss is probable and the amount of such loss.

No further action would be necessary if the Fund concluded that a loss, although possible, did not yet appear probable. Conversely, if a loss appeared probable, generally accepted accounting principles require that the Fund forthwith establish a provision against the full amount of the probable loss. Such a provision could be financed partly from the amounts accumulated in the existing Special Contingent Account; if the projected probable loss exceeded the balance in that account, the remainder would be financed from current income, possibly leading to a deficit which would be financed by a reduction of the Fund's reserves. If it were deemed desirable not to exhaust the Special Contingent Account--for example, because of overdue obligations of other members with protracted arrears--the provision could be financed partly from the Special Contingent Account and partly from current income. If the need for provisions exceeded the Fund's total of precautionary balances--namely, the sum total of balances in the Special Contingent Account and the Fund's reserves--these balances would be eliminated and the Fund's assets reduced below the total of Fund quotas. In that regard, it should be noted that in the Fund's early years--1948-56--expenditures continually exceeded income, and the consequent deficits reduced Fund assets below quotas. The Fund would then need to consider measures to repair the Fund's financial position following an impairment of its assets--as reflected, for example, in a substantial decline in precautionary balances.

In these exceptional circumstances, the Executive Board will have to consider the appropriate means to rebuild the precautionary balances. This normally would imply increasing the Fund's operating income or supplementing it by other exceptional means, which could include a sale of gold to be determined by an

85 percent majority. In this last resort case, the sale of part of the Fund's gold would help restore the Fund's net income position as a result of the General Resources Account retaining the "capital value" of the gold sold, and thereby reducing remuneration expense, and from income derived from investment of the proceeds in excess of the capital value.

Mr. Nimatallah said that he was in general agreement with the Chairman's statement. The proposed approach was feasible, and he particularly welcomed the case-by-case application of some of the basic features of the strengthened strategy, which would be helpful in view of the different situations of members with arrears. The possibility of the accumulation of charges falling due during the course of a Fund-monitored program, however, had not been mentioned. That option could help to avoid a program going off track owing to insufficient resources.

He still had doubts regarding the feasibility of the Arora proposal, Mr. Nimatallah remarked. He would like to see it applied in such a way as to encourage more members to participate in support groups, perhaps by inviting countries to join a support effort on an individual basis, rather than to provide that members which are projected to contribute less than 1 percent of quota under burden sharing would contribute the difference to an administered account in the form of loans at zero interest.

Mr. Posthumus recalled that Mr. Arora's original proposal had been broadly based, in that it had provided for a distribution of various financing efforts in the framework of support groups, including efforts to help the country to remain current, if necessary, and efforts to finance both the adjustment process and balance of payments needs. A later staff paper (EBS/90/23, 2/13/90) had limited the proposal to helping members to remain current, while the Chairman's statement had again broadened the proposal to include a new element, namely, that members' unremunerated positions should be taken into account when determining their contribution.

The formulation of the proposal had become increasingly difficult, Mr. Posthumus considered. He continued to hold the view that if members were to be asked to make voluntary contributions, quotas were not a good distribution key because other mechanisms were available. While he was not opposed to the Arora proposal, the present formulation did not sufficiently take into account other aid efforts of member countries. For instance, the Netherlands had a relatively large aid program--a fact that was not adequately reflected in the proposed mechanism for burden sharing. Moreover, Japan currently contributed more than 1 percent of quota to foreign assistance--an amount that was judged sufficient under the proposal--but in terms of national income, its efforts in that regard could reasonably be expected to be somewhat greater. The United States' situation was similar to that of Japan: its contribution to burden sharing was equivalent to 1 percent of quota, but its foreign aid in terms of national income was not high.

Management's presentation should perhaps be more cautious; it should at least recognize that the proposed distribution mechanism presented some problems and that most industrial creditor countries would have to do more than they were doing at present.

The Chairman remarked that Mr. Posthumus's point, namely, the need to keep in mind the overall international assistance effort of each country, was a fair one. At the same time, the Fund had to avoid the pitfalls inherent in trying to design a comprehensive comparison of burden sharing, which might be invidious, could complicate the process of dealing with members' arrears, and was more appropriately the responsibility of aid agencies in any case. It would be preferable to deal with the reinforcement of support group efforts without entering into such complex comparisons.

Mr. Posthumus said that he fully agreed with the Chairman, but the formulation needed to be somewhat more restrictive.

The Director of the Exchange and Trade Relations Department remarked that the use of funds contributed under an Arora-type scheme had indeed varied in successive staff proposals. Initially, the staff had envisaged that the funds would help to keep a member current. More recently, it had been further suggested that the funds could be used to reduce the burden of those members that were projected to contribute more than a certain amount under burden sharing. The current proposal returned to the earlier view on the use of voluntary contributions. The formulation was not watertight with respect to use, because it seemed prudent to allow for some flexibility if contributions under the scheme exceeded the amounts necessary to keep members current. He confirmed Mr. Landau's understanding that, under the Chairman's proposal, the proceeds of the Arora mechanism would be additional to the proceeds of burden sharing and that since more charges would be met by the arrears country, less pressure would be put upon the further burden-sharing mechanism that had been proposed by Mr. Dawson.

Mrs. Filardo observed that the new version of the Arora proposal was more complicated than earlier versions, especially because larger contributions were expected from those countries which had contributed more under the burden-sharing mechanism. That mechanism was unsatisfactory to creditors and debtors alike. The original Arora proposal was more attractive because it was based on new quotas and created additional resources to reinforce support group efforts. It also recognized the fact that support groups with industrial country members were experiencing difficulty in mobilizing resources because of constraints on the availability of aid and the earmarking of foreign assistance in some of their capitals. The resource problem therefore would most appropriately be addressed by a cooperative institution, namely, the Fund, in the context of a quota increase. Otherwise, the financing of Fund-supported programs with only an accumulation of rights following two or three years of a Fund-monitored program might not be sufficient to integrate countries into the world economy. In view of the prospective financing needs arising from recent developments in Eastern Europe and Latin America, among others, she favored strengthening the Fund through a quota increase of sufficient size to allow for setting aside a part of the increase to provide additional resources to reinforce support group efforts.

Mr. Ismael recalled that during the most recent Board discussion on financing the Fund's collaborative strategy, there had been virtually unanimous support for the principle that burden sharing should be based on Fund quotas. Moreover, despite some misgivings about its practicality, nearly all Directors had found the Arora proposal to be attractive. The question was how to give operative effect to voluntary contributions based on Fund quotas. Objections to the proposal had been raised owing to the need in many countries to go through budgetary procedures, the need to tailor loan agreements to suit each member's requirements, and the fact that many members felt that their contributions were already considerable.

The Chairman's proposal for a more limited concept of voluntary contributions had many merits, Mr. Ismael considered. First, it reduced by at least one half the number of contributing members, and hence, the number involved in budgetary and other procedures. Second, the rationale was consistent with quota-based burden sharing, which had already been accepted in principle. Finally, it was fair in the sense that unremunerated reserve tranche positions would also be taken into account as part of a member's contribution.

He could go along with the proposed use of voluntary contributions, namely, to pay charges falling due, Mr. Ismael stated. However, it might be more effective to permit the payment of charges in local currency so that the funds collected through the administered account could be used together with the member's own resources as well as those from support and consultative groups to keep members current during a Fund-monitored program.

Mr. Kafka said that he shared Mr. Ismael's views on the Chairman's formulation of the Arora proposal. In addition, it was unrealistic to restrict the proposal to 11 countries, although he fully saw the difficulties of any other approach. If another country fell into arrears, it would be manifestly unfair to treat it differently. Some solution was needed to avoid that eventuality, including an ad hoc decision at the time when such an unfortunate event occurred. Future cases of arrears could not be simply swept under the rug.

The Chairman remarked that he would be strongly reluctant to see the Fund establish a procedure that might encourage countries to choose to go into arrears. Instead, the Fund should have strong policies to prevent arrears as well as sound financial practices so that exceptional procedures--such as those under consideration--were not required. The current proposals aimed at liquidating past arrears and avoiding future problems, so that there would be no need for special procedures in the future.

Mr. Grosche said that the policies being formulated were, in his view, meant for the 11 current cases of protracted arrears and were not meant for any future cases that might arise.

Mr. Nimatallah commented that extending the proposed procedure to future arrears cases would discourage support groups from coming forward to help resolve the arrears problem. It had already been agreed that the current 11 arrears cases should be resolved and that measures should be taken to ensure that the problem would not recur.

Mr. Dawson recalled that his chair's views on the problems of voluntarism had been stated on earlier occasions. The Chairman's proposal with respect to the reinforcement of support groups would not have much effect on the U.S. position, even when unremunerated positions were taken into account in the burden-sharing mechanism. In that regard, he wondered how much additionality was envisaged and which countries could be expected to contribute more. It might be useful if other Directors could indicate what additional contributions could be expected under the proposal beyond the projected returns from burden sharing.

On Mr. Posthumus's point with respect to aid burdens, he associated himself with the Chairman's view that numerous denominators could be used to determine such burdens, Mr. Dawson continued. Moreover, one problem with suggesting to aid agencies that they needed to redirect, or possibly enhance, funds was that some of the 11 countries with arrears problems were not on aid agencies' priority lists--for a variety of reasons--and because agencies had different criteria for allocating their aid. That fact made the burden-sharing issue even more difficult. In that connection, he noted that his authorities had never accepted the UN target for official development assistance (ODA).

With regard to the revised Arora approach, he was not certain that, to the extent that the mechanism resulted in settlement of countries' charges that would not otherwise have been made, it would reduce demands on the mechanism for burden sharing, Mr. Dawson commented. The proposal for extending burden sharing would lower the floor for the rate of remuneration to 80 percent, and then adjust charges upward to generate half of that amount. The Arora plan might produce new money, but it was unclear how it would reduce members' contributions under the new burden-sharing proposal.

The Deputy Treasurer observed that if the deferred charges were shared on a 50/50 basis, as under Mr. Dawson's burden-sharing proposal, the Arora proposal would not reduce members' contribution to burden sharing. In that event, funds derived from the burden-sharing mechanism for deferred charges would flow into a new Special Contingent Account--SCA-2. Under the Chairman's proposal, however, the burden sharing ratio was not 50/50, but 50/25. The contribution of debtors was thus reduced, which would help free resources for the settlement of charges. In that sense, the proposal would put less burden on the burden-sharing mechanism.

In response to Mr. Dawson, the Deputy Treasurer confirmed that contributions to the Arora scheme could be viewed as helping to close the gap between the present and the proposed burden-sharing ratios--namely, 50/50 and 50/25--and would also provide a surplus of funds to the extent that a member's current payments for charges were financed by the support group.

Mrs. Filardo remarked that she understood that the Arora proposal aimed at mobilizing additional resources for support group efforts, while the proposal for burden sharing aimed at creating a further special contingent account to provide backing for resources disbursed under the rights approach. In view of the prospective resource requirements of the rights approach and the fact that eligible countries would already have established good programs and track records, she wondered whether additional resources should be diverted to a further special contingent account.

The Deputy Treasurer observed that the proposal to establish a new special contingent account was aimed at a different burden-sharing distribution which would result in the creation of additional resources. The Arora proposal would also provide additional financing from voluntary contributions to help keep members current in their charges or for some other agreed use. The staff felt that it would be necessary to continue with the existing Special Contingent Account for the time being, with burden sharing on a 50/50 basis. Under the proposal for a new special contingent account, there would be no use of the burden-sharing mechanism to cover deferred charges, because they would already be covered through the present Special Contingent Account. The second special contingent account would be financed on a 50/25 basis, down to a remuneration coefficient of 80 percent. The balances in that account would indeed be used to back the rights approach, but the account should also provide backing for the remaining overdue obligations of those countries that did not enter into Fund-monitored programs. In that sense, the new special contingent account would have dual purposes, unlike the present Special Contingent Account.

Mr. Landau commented that paragraph c of the suggested approach was a commentary on the final effect of the Arora scheme and seemed to create a great deal of misunderstanding, because the outturn could not be foreseen with certainty. He therefore considered that the paragraph could be deleted. The burden-sharing mechanism was, in any event, a separate issue and would be more appropriately addressed in the context of the proposal for a new special contingent account.

The Deputy Treasurer observed that paragraph c was technically correct in that overdue obligations would be burden shared on a 50/25 basis, and in that sense, there would be a release of resources for the debtors. The paragraph underlined that the principle of burden sharing still remained in some form, which was important. The paragraph could be deleted, if so desired, in order to treat the two proposals independently.

Mr. Enoch remarked that he agreed with Mr. Landau that the two proposals were independent and that paragraph c should be deleted. Moreover, paragraph c highlighted another problem, namely, that the Arora proposal resulted in the repayment of obligations backed by the existing Special Contingent Account, with symmetrical burden sharing, and that overall, burden sharing would become more asymmetric under the new mechanism. For those Directors who were unconvinced about the desirability of asymmetric burden sharing, the linkage between the proposed burden-sharing mechanism and the Arora scheme made the suggested approach even more unacceptable.

More important, he had some doubts about the amount of additionality to be provided under the Arora approach, Mr. Enoch commented. He was concerned that any additional resources generated by that approach would be used to settle charges rather than to finance adjustment. In the initial stages, at least, there should be less emphasis on the repayment of deferred charges.

The Director of the Exchange and Trade Relations Department explained that the intention was not to reimburse the Special Contingent Account, but to avoid further growth in the cost of burden sharing for deferred charges by helping arrears countries to meet regular payments falling due during a Fund-monitored program.

Mr. Dawson asked how the additional deferred charges for an arrears country which failed to make payments in the course of the years to 1992 would be treated.

The Deputy Treasurer remarked that additional deferred charges would continue to be covered using the present burden-sharing mechanism.

Mr. Grosche commented that he would caution against condoning the accumulation of charges under a Fund-monitored program. The financing of deferred charges would only reduce the amounts flowing into the new special contingent account. A further accumulation of arrears was not an option for consideration.

Mr. Evans observed that the projected financing was based on contributions by members projected to contribute less than, say, 1 percent of new quota under burden sharing rather than a firm base, such as the UN target for ODA. Those contributions could change markedly and quickly, as was seen with Poland, for example, and he wondered whether the proposed base was an appropriate one.

The Deputy Treasurer said that indeed the distribution of countries subject to the burden-sharing mechanism could change substantially from quarter to quarter. For example, two countries which were not on the original list of contributors--New Zealand and Poland--would, respectively, be added to the list of creditors or the list of debtors in the next quarter. Similarly, some creditors included in the current operational budget might draw on their reserve tranche position owing to a balance of payments need, thereby taking a neutral position in the Fund's operations. Indeed, the whole of the Fund's operations and transactions and the relative strength of members' balance of payments and reserve positions were reflected in the changing list of members subject to the burden-sharing decision, which changed rapidly from quarter to quarter.

The Chairman remarked that, in his view, the rationale for the proposed base for contribution was that it reflected members' actual positions as closely as was possible.

Mr. Evans stated that he had fewer problems with the revised Arora proposal than with earlier versions. He had no objection to any proposal aimed at strengthening support groups. However, he doubted that the proposed approach would produce the amounts of financing required. Among other problems, it lacked a sound basis. The Board had, however, been forced toward a voluntary approach because Directors had not been able to overcome their qualms about the use of the General Resources Account and burden sharing to solve the arrears problem. A further effort in that direction might be warranted before deciding upon a new approach.

The Directors were very close to agreeing upon the rights approach and the use of the General Resources Account, with appropriate backing, to support that approach, Mr. Evans observed. The proposed mechanism, however, resembled a very short-term bridging loan that would allow arrears to be cleared so that further disbursements could be made. In that respect, it could relieve the pressure on support groups by burden sharing through the General Resources Account.

He could agree to the proposal only if it was strictly limited to the 11 arrears countries, Mr. Evans remarked. Moreover, it should be limited to those countries with programs that held out the prospect of a return to external viability. Directors had agreed on that principle, which now had to be given operational content. Programs that could assure repayment would thereby strengthen the Fund. For that reason, he was prepared to look at proposals that he might not otherwise be willing to consider. The rights approach was preferable to putting too much reliance on voluntary contributions or support groups.

Mr. Yamazaki said that he welcomed the Chairman's efforts to help the Board reach a consensus on a strengthened arrears strategy. While his authorities were willing to approach the outstanding issues in the spirit of compromise, he had to reserve his chair's position pending consultation with his authorities on the most recent proposals. His comments were therefore personal and preliminary.

With respect to strengthening voluntary financing in the arrears strategy, his chair had strongly supported the support group approach, because the intensified collaborative approach aimed at strengthening the Fund's financial integrity by helping to clear arrears to the Fund, Mr. Yamazaki recalled. Although he continued to hold the view that the support group should play an important role in the context of a Fund-monitored program, he shared the various concerns that had been expressed by other Directors, particularly Mr. Clark, at previous discussions on the support group approach. In that connection, Mr. Arora's proposal merited further consideration in the context of supplementing support group efforts to mobilize multilateral and bilateral assistance.

It was essential for the success of the strengthened arrears strategy to ensure fair burden sharing among member countries and to supplement the burden-sharing and support group mechanisms through voluntary contributions from those member countries that were not participants in either mechanism, Mr. Yamazaki considered. Such a mechanism could increase the incentive to join the support group effort.

Mr. Enoch observed that if the revised Arora proposal was implemented as suggested and if it served to keep members current, under the present burden-sharing arrangements creditors would pay exactly the same amount, but with a lower--80 percent--rate of remuneration. However, debtors would pay less--50 percent less--insofar as the voluntary contributions served to keep members current because of the proposed asymmetric burden sharing. Thus, the greater the voluntary contributions, the less the counterpart provided by debtors.

That outcome posed two problems, namely, symmetry and equity, Mr. Enoch commented. Asymmetric burden sharing could deter members from contributing under the Arora proposal because in a sense they were not providing finance for the member in arrears but instead were relieving the existing burden-sharing obligations of the debtor countries. Thus, the two proposals were interrelated, essentially because of the asymmetry of burden sharing under the new special contingent account. That feature also raised the problem of equity. In his view, the whole package should be symmetric and equitable so as to encourage the success of the component parts.

In response to a question from the Chairman, Mr. Enoch said that he would be somewhat more comfortable with a formulation that stressed that keeping current during the program period was, first, the task of the country, and second, the task of the support group, reinforced as envisaged under the Arora proposal. The suggested approach could be further improved by providing that asymmetry would arise only beyond a certain level. For example, if the existing Special Contingent Account were maintained at its original level, then asymmetry would arise only at the margin.

Mrs. Filardo commented that she also questioned the asymmetric treatment in the suggested approach, particularly from the point of view of the debtors.

Mr. Filosa recalled that the original Arora proposal was very simple. The revised version sought to include an element of fairness, but that apparently was far from being achieved. In addition, the proposal had implications for burden sharing that were not entirely known. He agreed with Mr. Dawson on the need to understand the implications of the mechanism for contributions. Moreover, he wondered how much additionality was envisaged and which countries were expected to make voluntary contributions. Until the ramifications of the proposal were clear, he could not take a position on the matter. He could only agree on the need for a more equitable burden-sharing mechanism and for additional quota-based contributions to help finance support group efforts.

He would prefer a simpler approach, entirely independent of the proposal for a new special contingent account, Mr. Filosa commented. A clear, precise description of the envisaged burden-sharing mechanism would be helpful.

The Chairman remarked that he agreed with Mr. Filosa on the need for simplicity, which he would try to satisfy in presenting the final package. The objective was to achieve additionality within a framework of simplicity.

Mr. Grosche commented that in the quest for simplicity, countries which were being asked to be major contributors to the support group should not be given an escape clause. The misperception that the Fund would assure additionality through an Arora-type mechanism must be avoided.

Mr. Fogelholm stated that his view was similar to Mr. Filosa's. He believed that Mr. Arora's original proposal had been altered to such an extent that it should no longer bear his name. In fact, the suggested version was nothing more than the support group approach. Nonetheless, he would not object to its inclusion because it could provide some additional resources, although he remained skeptical about its likely contribution to financing members' obligations to the Fund.

Mr. Arora said that he welcomed the Chairman's statement, which put together the elements needed to reach an agreement on a particularly complex issue. He understood from the discussion that the present burden-sharing arrangement for the existing Special Contingent Account would continue. In addition, there would be a separate burden-sharing mechanism, a second special contingent account, which would have the limited objective to back financing under the rights approach.

The original idea was more comprehensive with respect to burden sharing and would have had some beneficial impact on the debtor countries, but as that approach had not been found to be practical, a limited concept had been put forward, Mr. Arora observed. He had no objection to the limited version at all, but in his view, the additional burden would fall on the debtor countries, and that was a matter of concern. He wondered what increase in the rate of charge was foreseen under the proposed approach.

He wished to underline the confidence expressed by the Chairman in the support group mechanism, Mr. Arora commented. The previous day Directors had discussed, under the chairmanship of the Deputy Managing Director, the support group for the financial program for Zambia. For 1990 alone, Zambia's financing requirements were put at SDR 500 million, which included an element of financing for the program as well as to help Zambia keep current. Moreover, the medium-term balance of payments situation was not optimistic. Therefore, it was doubtful that the support group, together with the country, would be able to muster the resources needed for Zambia to keep current. If the proposal for a quota-based mechanism was considered to be impractical, the idea to utilize other suggestions that had been put forward by Executive Directors should be reinforced, because some of those flexible ideas would be needed to make the Fund-supported programs a success and to avoid a situation where arrears would again accumulate.

The Chairman remarked that he could imagine individual cases that were so difficult that it would be necessary to ask support group members for contributions exceeding 1 percent of their quota in order to eliminate a country's arrears problem. Such a request was within the spirit of the case-by-case approach, and if it was perceived by the membership as a way of erasing the past without creating a precedent for the future, it would not appear to be unreasonable. So, while he understood Mr. Arora's skepticism about the amount of support group financing to be expected, it should be accepted that the Fund might have to call upon the membership for an exceptional effort to assist a member which was making a strenuous effort to implement an adjustment program.

Mr. Posthumus, commenting on the suggested approach to financing the rights approach, said that paragraph c might be understood to imply that the stronger the performance of a country under a Fund-monitored program, the more likely it was that it could use the resources of the enhanced structural adjustment facility, rather than those of the General Resources Account. As that was not the intention, the paragraph should be reformulated to avoid any misunderstanding of the exceptional use of the enhanced structural adjustment facility.

The Chairman observed that a subsequent arrangement would involve upper tranche conditionality, which would apply to the use of both the extended Fund and the enhanced structural adjustment facilities. The paragraph could perhaps be amended to underline Directors' calls for extreme prudence in utilizing the resources of the enhanced structural adjustment facility, and to indicate that the final decision on the use of resources would have to be taken on a case-by-case basis and in the light of the merits of each program. In noting Mr. Posthumus's point, he wanted to stress that any use of resources would have to be in support of high-quality programs.

Mr. Feldman considered that the idea of an "eventual exercise of rights" needed further analysis and consideration. In particular, he wondered whether the reference to Mr. Posthumus's earlier proposal meant that one way of exercising rights could be the deaccumulation of arrears. In any event, the meaning of "exercise of rights" was open and might have several interpretations.

The Chairman remarked that the reference in his statement to suggestions that had been made that might help, if not generally, then in particular cases, was unrelated to his outline of the proposed alternative approach. The latter approach would be followed for the 11 arrears cases, and should suffice for many of them. But because the clearance of arrears could be difficult and as the Fund had no experience as yet in clearing arrears, a few other suggestions made by Directors--which, while not generally agreed, were interesting and conformed to the Articles--should be kept in reserve. For instance, Mr. Posthumus's suggestion might be considered if the Board could not accomplish its objectives through the proposed approach.

Mr. Feldman stated that he welcomed the Chairman's clarification, which implied that the exercise of rights would be interpreted flexibly and on a case-by-case basis. He would also appreciate some clarification with respect to paragraph b of the proposed alternative approach. In particular, the reference to "the use of Fund resources on an appropriate scale" raised difficulties because of Directors' concerns about prolonged use and the need to scale down the amounts of Fund financing in subsequent programs.

The Chairman responded that in reaching a judgment on what would be the appropriate scale, the Board would have to balance the need for adequate financing of a member's adjustment effort and its concern to preserve the monetary character of the Fund. The formulation also recognized that in view of the large amounts of accumulated arrears, a few countries might require exceptional treatment. For that reason, he had suggested that the general approach be restricted to the 11 cases of protracted arrears, so as to insulate those cases for which some recourse to exceptional access and phasing might be necessary.

Mr. Feldman said that in that connection, he wondered whether the double limitation--namely, to 11 countries, and of those, to only the countries entering into a Fund-monitored program before the end of 1990--was necessary. It was possible that some countries which were prepared to elaborate an adjustment program might need a longer time to do so than the end of 1990.

The Chairman remarked that the limitation was, of course, for the judgment of the Board. Directors had generally agreed on insulating the 11 cases. The second limitation--to members with programs started before the end of 1990--reflected the desire to eliminate the arrears problem as soon as possible. It was for the Board to decide whether management and the staff were too ambitious in that regard.

Mr. Finaish asked whether the reference to the use of resources in paragraph c related to the Fund-monitored program or to the subsequent program. If it applied to the subsequent program, he wondered what was the rationale for an exceptional use of the enhanced structural adjustment facility.

The Chairman explained that Directors had observed that the Fund-monitored program and the subsequent program were closely connected, and for that reason, he had not proposed to distinguish precisely between the two or to draw a strong contrast between them. Both programs could work together to help the country to return to a viable situation.

Mr. Kafka said that he did not see the logic of paragraph b. In particular, if a country received financial support to clear its arrears, it would appear punitive to force it subsequently to accept the financial support of the Fund or a program with no additional support, even though the member continued to meet its obligations in a timely manner. The purpose should be to reduce the number of countries having arrangements with the Fund, and especially zero access arrangements. He could not accept that point.

The Chairman remarked that he understood Mr. Kafka's concern about reducing the number of Fund-supported programs. At the same time, in view of the accumulated arrears of, and the prospects for, the 11 countries, a subsequent arrangement with the Fund following a Fund-monitored program would be inescapable. It was preferable, in his view, to be frank with members and to tell them that that would be the normal course of action.

Mr. Kafka stated that he still could not understand the logic of the proposal. Once a country had completed a Fund-monitored program it would draw its rights and would then be in the same position as any other borrower from the Fund. At that point, it would repay, or would not repay, its obligations in a timely manner. If it did not repay, it would be subject to all the sanctions of the arrears strategy. If it repaid, he saw no reason why the member had to have a program. Such a requirement would mean that any country which had ever borrowed from the Fund would have to have a zero access program until such time as it had fully repaid its purchases. He could not support the proposal as it stood.

Mr. Dawson remarked that in his view, the exercise of rights should be viewed as a refinancing of the accumulated arrears into an immediate program, so that the activation of rights involved the creation of a new amount of credit outstanding. Indeed, for a number of countries the amounts would be equivalent to a large percentage of quota outstanding. It would be irresponsible to approve new credits of such magnitude without simultaneously approving a new arrangement with the Fund.

Mr. Kafka observed that the exercise of rights could only take place after the country had successfully completed a two- or three-year Fund-monitored program. The transformation took place as the result, or as a reward for, the completion of that program. There was therefore no need for the further condition of approval of a subsequent program.

On limiting the alternative approach to the 11 countries with protracted arrears, Mr. Kafka said that he would reserve his position for the reasons he had given earlier.

The Chairman said that if, after the completion of a Fund-monitored program, the member's situation was such that it would not need a successor program, he would be delighted not to have to recommend one; but that was unlikely.

The Director of the Exchange and Trade Relations Department observed that the proposed approach was based on two considerations. The first was a matter of practicality: even after, say, a three-year program of good performance, the country in question would almost certainly have had to reschedule a whole series of obligations other than those to the Fund. Therefore, the financing needs of that country over the subsequent period might well be unusually large. A second consideration--and a basic principle--was that the exercise of rights would involve a large, front-loaded disbursement of resources, which although surely justified by three years of good performance, was still a highly exceptional disbursement. In that sense, it would be prudent for the Fund to ensure that the member's economic performance remained on line for a certain period of time by means of an arrangement with the Fund.

Mr. Nimatallah said that paragraph c was well formulated and should be retained as it stood because it skillfully covered all possibilities.

Mr. Grosche remarked that he understood that the rights to be exercised were for a front-loaded program. Thus, the rights could not be activated without a new program. As to the new program, he was concerned about the amount of access to be granted in individual cases. High access could place a heavy debt-servicing burden on a country immediately from the outset of a new program. In that regard, he was still grappling with the idea of allowing a country to stretch somewhat the repayment of overdue charges over time, which meant that creditors and debtors of the Fund would have to wait a little longer for repayment of the resources that they had provided under the burden-sharing arrangement. If overdue charges that had been accumulated prior to the start of the Fund-monitored program--and which had been covered through burden sharing--could be cleared over time in line with the new program's progress, then access to the General Resources Account could, at the very beginning, be limited to the amount necessary to repurchase the overdue obligations. Of course, countries would need fresh money during the new program, and those countries that were eligible to use the structural adjustment and enhanced structural adjustment facilities could certainly draw on those resources in that period.

Such resources were not, however, meant to refinance overdue obligations and charges, Mr. Grosche stressed. No transfers of risk should take place from creditors of the General Resources Account to creditors of the ESAF Trust. Moreover, the enhanced structural adjustment facility was devised to assist a country to implement structural reforms over time, and disbursements under that facility were to be made in line with a program's progress. Some flexibility was possible, but he still had some problems with paragraph c and would have to reserve his final position on that point.

Mrs. Filardo said that she liked paragraph c and was not as optimistic as Mr. Kafka about the need for a subsequent arrangement. Her only concern was that countries would have to demonstrate their willingness to cooperate before the end of 1990. That was a very short period of time in which to initiate a program, especially in view of the circumstances of many of the 11 countries.

Mr. Nimatallah remarked that he understood that any references to an accumulation of arrears meant new arrears; the old arrears would be cleared through bridge financing and the repayment of bridge financing upon the member's activation of its rights.

Mr. Dawson commented that he understood that Mr. Grosche was willing, in principle, to contemplate the use of the resources of the enhanced structural adjustment facility to repay that portion of old arrears that was attributable to charges.

Mr. Grosche remarked that overdue repurchases should be settled through a bridge into a new Fund-supported program. He was, however, concerned about the high level of access that was needed if overdue charges were included and the immediate high debt-service burden for the country vis-à-vis the Fund. In respect of overdue charges, he could perhaps consider the possibility to schedule repayments over a longer period. That could be done, for example, by granting access to the resources of the General Resources Account during the course of the new program rather than in one front-loaded purchase; the purchases could be used to settle the charges over time, and, as a result, the burden of servicing new drawings would be somewhat lower, and participants in the burden-sharing arrangement would have to wait longer to be repaid.

As far as fresh money was concerned, the resources of the structural adjustment and enhanced structural adjustment facilities could be used to provide support for a growth-oriented adjustment program, but not to settle overdue charges or overdue obligations, Mr. Grosche concluded.

Mr. Dawson observed that Mr. Grosche's proposal was not particularly generous. For many of the 11 countries, once their rights were exercised to finance substantial repurchases, little would remain for financing a new program. On another issue, he remained opposed to the idea of a deaccumulation of rights. In his view, that approach would be of little benefit to the country because, in effect, a deaccumulation of arrears through a periodic exercise of rights could capitalize previously deferred charges.

Mr. Grosche stated that he agreed with Mr. Dawson regarding the deaccumulation of arrears. As to the question of fresh money, it would only come from the structural adjustment and enhanced structural adjustment facilities: the outstanding amounts in the General Resources Account would not be increased. The use of General Account resources was relatively expensive, and that Account should not be viewed as a source of additional fresh money. However, he was not dogmatic on that point: a small amount of access to those resources might be necessary, but he would prefer that fresh money should come primarily from concessionary resources.

The Chairman asked whether Mr. Grosche could accept that after a country had exercised its rights, it could use the resources of the enhanced structural adjustment facility to repay the General Resources Account.

Mr. Grosche said that while he recognized the fungibility of financing, he understood that a bridge necessary to effect the overdue repurchases would be refinanced through access to the General Resources Account in the context of a new Fund program. The new program would in principle not provide for new cash for the country concerned. But the enhanced structural adjustment facility could provide fresh money to finance good programs. Thus, there was no need for using resources of the enhanced structural adjustment facility to settle the overdue repurchases, and overdue charges could be dealt with through their scheduled decumulation.

Mr. Landau remarked that he understood Mr. Grosche's concern that at the end of the Fund-monitored program there should not be too much front-loading, because that could create new debt-servicing problems for the member. As to his proposal to "reschedule" the overdue charges that had been accumulated since the beginning of the Fund-monitored program, while he agreed with the substance, in effect, the Fund would be granting access to a country which was legally and technically still in arrears. That possibility had to be avoided. He wondered whether the proposal could be reformulated so as to avoid front-loading as well as granting access to a country which was technically in arrears.

He strongly supported the idea of a subsequent program, Mr. Landau commented. To allow substantial drawings on the Fund at the end of the Fund-monitored program without providing for a further arrangement with the Fund would change the whole philosophy underlying the rights approach.

Mr. Dawson remarked that he still had difficulty understanding how Mr. Grosche's suggestion would benefit an arrears country. Under that approach, in 1992 a country would have earned its rights and a series of transactions would take place. The previously deferred charges that had been handled under burden sharing would continue and would be refinanced in some fashion, or be discharged in some kind of balloon payment somewhere down the road. Repurchases amounting to approximately $2 billion would then be transformed in some fashion into new credit outstanding, which would accrue new charges at traditional Fund rates. In addition, Mr. Grosche was willing to see those countries which were eligible to use the structural adjustment and the enhanced structural adjustment facilities receive new money. That approach would create a substantial financing burden for the countries concerned.

For example, Peru's overdue obligations were equivalent to almost 200 percent of quota, Mr. Dawson commented. Zambia's were equivalent to 278 percent of quota. Under the suggested approach, those two countries would be expected to continue to meet new charges on that amount as well as to make repayments. In contrast, the use of the resources of the structural adjustment or enhanced structural adjustment facility would lower their debt burden. In that regard, it should also be recalled that part of the problem in the past was that the rate of charge had been inappropriate in the light of the payment capacity of some countries, and certainly that of IDA-eligible countries.

The Director of the Exchange and Trade Relations Department observed that Directors had raised two problems, which were closely interrelated. The first was that the use of rights to help repay bridge financing arranged to clear accumulated overdue obligations--both repurchases and charges--would result in a large initial drawing for some countries. That, as Mr. Evans recalled, had been accepted by most Directors with some reluctance. The second problem was that unless the rights were financed by some combination of the use of the enhanced structural adjustment facility and the General Resources Account, the later accumulation of charges could become a problem, as Mr. Dawson had correctly pointed out. He wondered whether the difficulty could be avoided by building on the Chairman's suggestion that after a short period of time following a purchase of general resources, a country could draw on the enhanced structural adjustment facility on the understanding that part of the disbursement would be used to make repurchases from the General Resources Account; the total amount outstanding would not change, but the charges would be sharply diminished.

Mr. Grosche said that while he recognized the problem, the staff's suggestion would transfer risk from the international community to a few creditors who were not protected, and that was another problem. Since granting access to regular Fund resources in the amounts necessary to clear overdue repurchases and charges would create another heavy burden on countries in terms of future charges, he wondered whether there was a way--without creating legally difficult circumstances--to delay the settlement of charges.

The Chairman commented that Directors had offered valuable suggestions, each of which posed some difficulties. In particular, he had noted Mr. Grosche's point on the security of claims on the ESAF Trust. In that regard, he recalled that it had already been strongly established that the use of the Fund's gold to secure claims was a possibility.

Mr. Grosche recalled that the United States had not been willing to commit itself to the use of the Fund's gold for that purpose, but if there was a firm commitment on the part of the United States to accept the sale of gold in order to safeguard the resources of the enhanced structural adjustment facility, his position on the use of that facility might change.

Another possibility was the creation of a special window to permit access to the regular resources of the Fund, with longer repurchase periods, and on concessional terms, Mr. Grosche commented. The international community could commit itself to continue the burden-sharing arrangement, but with somewhat lower charges on such drawings to allow for concessionality. The loss in income for the institution would be borne by debtors and creditors as in the current burden-sharing arrangement.

Mr. Landau remarked that one way to allow a country to restructure its overdue charges at the end of the Fund-monitored program without being legally in arrears under the Articles was to allow payments in local currency, as had been suggested earlier by Mr. de Groote.

The Chairman said that such a solution might create other problems, and he would therefore prefer to try to find one solution along the lines of the proposed approach.

Mr. Landau stated that with respect to the Fund-monitored program, his authorities had some reservations about the use of the enhanced structural adjustment facility. To be prepared to consider the use of the enhanced structural adjustment facility, they would need some further strengthening of the Fund's guarantee to lenders, including the pledge with respect to the use of the Fund's gold.

As to financing at the end of the Fund-monitored program, the provisions of paragraph c were appropriate, Mr. Landau considered. They neither prejudged nor excluded the use of the enhanced structural adjustment facility or the General Resources Account at the end of the Fund-monitored program. The wording was appropriate and left the final decision to the judgment of the Board at the appropriate time.

Mr. Dawson said that he could accept the end of 1990 as the deadline for an arrears country to enter into a Fund-monitored program.

Mr. Nimatallah said that paragraph c was well formulated and flexible. It could, for example, allow for dividing the arrears into four portions--namely, past due charges, future charges, past due repurchases, and future repurchases. Future repurchases were the responsibility of the country, and preferably would be cleared with the help of a support group. Future charges could possibly be left to accumulate as had been suggested. They would not affect front-loading, and they would be cleared over time. Past charges and repurchases would be cleared, first, by a bridge loan, and second, by the use of the enhanced structural adjustment facility from the outset of the subsequent arrangement. Of course, there might not be any need for a subsequent arrangement if the member was able to come to grips with its financing problem.

If a country required substantial front-loaded assistance, it might be possible to envisage a series of programs with financing on various terms, Mr. Nimatallah commented. For example, a front-loaded, six-month stand-by arrangement financed from the General Resources Account could be followed by another Fund-supported program under the structural adjustment or enhanced structural adjustment facility. Under that approach, the country would bear the brunt of a high rate of charge for a short period of time, but in subsequent years, the rate of charge would be at a concessional level. Paragraph c was attractive because it provided such flexibility, so that the approach could be tailored to each case.

Mr. Ismael said that he agreed that to rely only on the General Resources Account would make financing too expensive, particularly since regular and enlarged burden sharing was being emphasized. Therefore, once rights had been accumulated and a way had been found to clear arrears, both the General Resources Account and the enhanced structural adjustment facility should be used to help finance the arrangement that followed the Fund-monitored program. He could go along with the Chairman's suggestion of a case-by-case consideration of such financing. So as not to discourage countries which may have already entered into--or were on the verge of entering into--a program, he would also like to add a provision to the effect that member countries which were already following Fund-monitored programs with upper credit tranche conditionality when the new collaborative approach became effective should receive rights retroactively for performance during past programs as well as in the event that they decided to participate in the rights approach.

Mr. Fogelholm remarked that he agreed that the countries themselves should try to solve the problem of keeping current with the help of support groups. However, he was willing to consider the use of the resources of the Special Disbursement Account to reinforce support group efforts. He did not know, however, whether it was wise to include that possibility as part of a policy statement, because if the use of Fund resources was mentioned at the outset, the support groups--or the countries themselves--might not be willing to make the effort required of them.

In the past his chair had opposed the use of the enhanced structural adjustment facility to finance the rights approach, Mr. Fogelholm recalled. His authorities had, however, reconsidered their position, and they were currently willing, to a limited extent, to allow the use of that facility, including in some combination with the resources of the General Resources Account, particularly in light of the fact that there was no mention of gold sales in the Chairman's proposal. Their support was, however, conditional on the latter point as well as on an acceptable increase in quotas.

Mr. El Kogali stated that the end-1990 cutoff date was too early. He was in general agreement with the proposals so long as they were implemented with flexibility. Some countries might require more time--more space to maneuver--to achieve a consensus or effect a change of government.

Mr. Dawson said that he wished to register some general and long-standing concerns with respect to the suggested approach. Clearly, an exercise of rights would be triggered at the end of the Fund-monitored program. In that connection, he did not see how a deaccumulation of rights would work, and it could potentially create a moral hazard problem. He agreed with paragraph b with respect to the nature of a follow-on program.

With regard to paragraph c, he thought that one reason why Mr. Nimatallah had called it "skillful" was because it offered something to everyone and was also somewhat vague, Mr. Dawson observed. In his view, the proposal had to be carefully formulated and clear, particularly with regard to the use of the General Resources Account, which was not acceptable to his chair because it represented a rescheduling when those resources were viewed as ordinary quota resources.

He wondered how the new special contingent account was envisaged to provide backing to strengthen the General Resources Account in a legal sense, Mr. Dawson continued. In his earlier proposal, refinancing would occur through an augmented General Resources Account, with augmentation being achieved through additional burden sharing or the sale of gold.

He agreed with the Chairman on the use of the structural adjustment and enhanced structural adjustment facilities, particularly to ensure that the exercise of rights did not leave a country with an unsustainable financing burden in terms of the cost of new funds, Mr. Dawson stated. Limiting the approach to the 11 countries and the end-1990 deadline were also acceptable to him. He had some concern about how potential new arrears cases would be treated, and that possibility had to be considered as an integral part of the arrears strategy. The strategy so far was geared toward the 11 countries which were currently in arrears, but a system focused on preventive and remedial measures had to be in place to deal with new instances of arrears. The three elements of the strategy and the countries to which they applied had to be clearly understood to avoid the possibility of additional countries pressing for exceptional financing to clear arrears. The approach must be credible and tough in the areas of preventive and remedial measures so as to diminish that likelihood.

The Chairman, commenting on Mr. Dawson's last point, said that clearly, exceptional financing would apply to the 11 countries with protracted arrears, while the other measures would apply to all members falling into arrears in the future.

Mr. Enoch remarked that he strongly agreed with the sentiments expressed in paragraphs a and b of the proposal. Similarly, paragraph c was flexible enough to be acceptable to all parties, and he could therefore go along with the proposed formulation.

The reference to the determination by the Executive Board regarding the resources to be used implied a certain amount of ex post determination, whereas clearly determination must be ex ante, because the overall financing burden would be considerably greater insofar as the resources of the enhanced structural adjustment facility were not used, Mr. Enoch observed. In practice, a determination would be made initially by the support group, and then would be formally ratified by the Executive Board.

As to the use of the enhanced structural adjustment facility, he hoped that the Board could accept the flexible formulation that had been proposed, Mr. Enoch commented. Mr. Grosche seemed to suggest that if gold was used to back the resources of that facility, he would have fewer problems with the proposal. In that regard, he wondered whether backing by a new special contingent account would similarly meet Mr. Grosche's concerns.

The proposal to delay the discharge of overdue charges was interesting but would need some technical analysis, particularly with respect to its cash flow implications, Mr. Enoch observed. Whether that approach would be helpful depended on the amount of charges and the opportunity costs involved. There might also be some legal considerations. For instance, the proposal assumed that the Fund was not at risk because the charges had already been burden shared. If some legal way could be found to transfer the claims from the General Resources Account to the creditors, the Fund itself would not be at risk, and the approach could be a helpful way forward.

The end-1990 deadline was welcome as well as the limitation of the financing approach to the 11 arrears countries, Mr. Enoch commented. Indeed, the last point was very important. The Board was considering the provision of exceptional financing, and many members' authorities were prepared to make exceptional efforts only if they were limited to a few countries.

Of the suggestions that might be helpful in particular cases, Directors had earlier indicated more support for using the Special Disbursement Account as a source of finance, Mr. Enoch recalled. His own authorities were considerably more likely to reconsider their position--which was initially negative--on the use of that account, especially if a successful track record had been established by the country.

As to Mr. Fogelholm's concern about mentioning the possible use of Fund financing, in his view, the omission of that possibility could have a negative effect on potential contributors, Mr. Enoch commented. If the apparent financing gap was too large, the support group might regard it as impossible to fill. The gap for Zambia, for instance, was so large that without the possibility of some Fund assistance to help close that gap, members might be deterred from joining a support group.

The Chairman remarked that, indeed, the possibility of Fund financing, on a case-by-case basis, might be needed to ensure that the financing gap would not be so large that support groups would be deterred from even attempting to fill it. Nevertheless, it should be expected that the support group effort would suffice, without the support of the Special Disbursement Account.

Mr. Filosa said that he agreed with the proposals on financing the rights approach. In particular, he welcomed paragraphs a and b, and his authorities--who on previous occasions had been reluctant to concede the use of the enhanced structural adjustment facility--could agree to its use in the exercise. As to use of the resources of the General Resources Account for a substantial part of the financing under the rights approach, some technical work was required to determine the implications of such financing for the debt burden of recipient countries before he could take a final position on that matter. In particular, it would be helpful to know to what extent the use of the enhanced structural adjustment facility would reduce charges.

He strongly supported the end-1990 deadline for entering into a Fund-monitored program, Mr. Filosa commented. As he had suggested on a previous occasion, it should be further indicated that at least one or two years should lapse before a track record was established. That approach might meet the concerns of both Mr. Fogelholm and Mr. Enoch about the impact of possible Fund financial assistance on the support group effort.

Mr. Arora remarked that the proposed approach was acceptable, particularly paragraph c, which was flexible and would permit decisions to help solve the arrears problem. The issue was to find a way to finance rights so that the burden on the arrears country was not so great as to give rise to another arrears problem. For that reason, he believed that a combination of General Resources Account and other resources was justified. Those resources should be combined in proportions that created a manageable debt burden.

As to a new special contingent account, the Board had earlier envisaged that burden sharing would take care of the deferred charges, Mr. Arora recalled. The proposal to establish a further special contingent account introduced a new concept, namely, to try to safeguard in some measure even the resources to be lent from the General Resources Account. He would have to consider that matter further, particularly as the Fund would provide its resources to a member only after three years of a rigorous Fund-monitored program. He was as yet unconvinced of a need for even more security.

Mr. Yamazaki said that he wished to clarify further his position on the use of the enhanced structural adjustment facility to finance the rights approach. As he had stated on previous occasions, his authorities did not expect that the resources of the enhanced structural adjustment facility would be used to refinance arrears to the General Resources Account when they agreed on the loan contribution to that facility. Therefore, he did not think that his authorities could accept the use of the enhanced structural adjustment facility to finance the rights approach. He was also sure that his authorities would take into consideration the Board's discussion on arrears when they decided on the extension of the cutoff date of the loan contribution. His authorities were, however, ready to consider providing enhanced structural adjustment facility resources on an exceptional basis once a country had cleared its arrears to the Fund.

He would appreciate it if the Board made it clear that the enhanced structural adjustment facility would be used only in a forward-looking manner as the Chairman had proposed, Mr. Yamazaki commented. He continued to consider it inappropriate for the Fund to provide its resources to a country in arrears to the Fund because that approach could give rise to misgivings in the international financial community about the Fund's policies.

Mr. Kafka said that he welcomed Mr. Ismael's suggestion that countries presently implementing programs should be entitled to earn rights, but he had assumed that once the rights approach was approved, a country currently participating in the cooperative approach would also be entitled to earn rights if it so desired and fulfilled the conditions for that purpose. A more difficult question arose with respect to the possible retroactivity in favor of a country which was, or had been, under the rights approach. He would like to hear the staff's comments on that matter.

On a technical point, it had been suggested that a country under the cooperative approach might be asked to build up budgetary resources for paying its arrears, Mr. Kafka observed. That was an interesting idea that merited analysis as well as further discussion.

Mr. Nimatallah remarked that the proposal with respect to the role of support groups in helping members to meet their obligations falling due during the Fund-monitored program could be strengthened by referring to Mr. Finaish's proposal to widen the support group, introduce equity, and try to give some leadership to the Fund in terms of moral suasion. In that connection, he believed that the Fund could take a slightly stronger position by stating at the outset that a certain number of countries would be needed for the support group effort in view of the magnitude of the resources needed over a certain period of time. It could also suggest a timetable and, of course, it would establish an escrow account. The support group should not be left with little guidance. Countries might be more forthcoming if they were asked to contribute by name.

The Chairman said that he was grateful for Directors' comments, which would be helpful in finalizing proposals on the strengthened arrears strategy. Management and the staff would try to build on the suggestions that had been made and provide clarifications on several points that had been mentioned by Directors.

At the present stage, the matter of the establishment of a new special contingent account did not need to be decided, the Chairman observed. The Board could return to that issue on the occasion of its review of burden sharing and the Fund's income position. He proposed to consider the financial consequences of compulsory withdrawal in the afternoon. That was an important matter on which Directors had not yet fully elaborated their views, particularly with respect to the sale of gold as a last resort to restore the Fund's income position in the event of a member's withdrawal from the Fund.

The Executive Directors agreed to resume their discussion in the afternoon.

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/90/23 (2/21/90) and EBM/90/24 (2/23/90).

2. ANTIGUA AND BARBUDA - 1989 ARTICLE IV CONSULTATION - POSTPONEMENT

Notwithstanding the period of three months specified in Procedure II of the document entitled "Surveillance over Exchange Rate Policies" attached to Decision No. 5392-(77/63), adopted April 29, 1977, as amended, the Executive Board agrees to extend the period for completing the 1989 Article IV consultation with Antigua and Barbuda to not later than March 5, 1990. (EBD/90/56, 2/15/90)

Decision No. 9368-(90/24), adopted
February 21, 1990

3. PEOPLE'S REPUBLIC OF CHINA - 1989 ARTICLE IV CONSULTATION - POSTPONEMENT

Notwithstanding the period of three months specified in Procedure II of the document entitled "Surveillance over Exchange Rate Policies" attached to Decision No. 5392-(77/63), adopted April 29, 1977, as amended, the Executive Board agrees to extend the period for completing the 1989 Article IV consultation with the People's Republic of China to not later than February 28, 1990. (EBD/90/54, 2/15/90)

Decision No. 9369-(90/24), adopted
February 21, 1990

4. DJIBOUTI - 1989 ARTICLE IV CONSULTATION - POSTPONEMENT

Notwithstanding the period of three months specified in Procedure II of the document entitled "Surveillance over Exchange Rate Policies" attached to Decision No. 5392-(77/63), adopted April 29, 1977, as amended, the Executive Board agrees to extend the period for completing the 1989 Article IV consultation with Djibouti to not later than March 2, 1990. (EBD/90/55, 2/15/90)

Decision No. 9370-(90/24), adopted
February 21, 1990

5. EXECUTIVE BOARD TRAVEL

Travel by Executive Directors as set forth in EBAP/90/46 (2/20/90) and EBAP/90/47 (2/21/90) is approved.

APPROVED: November 29, 1990

LEO VAN HOUTVEN
Secretary

Legal Aspects of Settlement of Accounts
Upon Compulsory Withdrawal

Article XXVI, Section 3 prescribes that upon withdrawal of a member (i) normal operations and transactions of the Fund in its currency shall cease, (ii) settlement of all accounts between it and the Fund shall be made with reasonable dispatch by agreement between it and the Fund, and (iii) if agreement is not reached promptly, the provisions of Schedule J shall apply to the settlement of accounts.

a. Schedule J, paragraph 4 provides that if, after offsetting the withdrawing member's claims on the Fund against its debt to the Fund, the Fund's holdings of the member's currency exceed the amount due to the member, the member must redeem these excess holdings in a freely usable currency. Should the member fail to complete redemption within five years of the date of withdrawal, or within such longer period as many be fixed by the Fund, "the Fund may in an orderly manner liquidate in any market the amount of currency which should have been redeemed" (paragraph 4). The withdrawing member must compensate the Fund for any loss resulting from the difference in the SDR value of its currency between the date of withdrawal and the date of disposal by the Fund (paragraph 6).

Gold paid to the Fund under a quota subscription is the exclusive property of the Fund (Article XIII, Section 2(b)), and a Decision of the Executive Board of 1947 1/ clarifies that "gold and currency subscribed to the Fund are clearly within its unrestricted ownership. They do not belong in any way to the subscriber."

There is, consequently, no special treatment of a subscription payment made in gold when accounts are settled with the withdrawing member. The gold is retained by the Fund (valued at the historical official rate of SDR 35). Thus, there is a capital gain (though unrealized) for the Fund's membership. After withdrawal, the former member will no longer be entitled to participate either in any sale of gold at the historical official price under Article V, Section 12(e), or in any distribution of a profit under Article V, Section 12(f)(iii) or upon the Fund's liquidation under Schedule K.

b. Upon compulsory withdrawal, the Fund's maintenance of value provisions under Article V, Sections 10 and 11 cease to apply. Consequently, the Fund could, after withdrawal, value the currency holdings of a member at

1/ Decision No. 170-3, adopted May 20, 1947, Selected Decisions, Fourteenth Issue, p. 3.

the expected realizable value, below the previous SDR value. 1/ The Articles recognize the possibility of a loss in connection with the liquidation of the Fund (Schedule K, paragraph 8) and after the withdrawal of a member (Schedule J, paragraph 6).

However, the specific settlement and compensation procedures of Schedule J would need to be taken into account. To the extent that there is a depreciation of holdings and ultimately a difference between the value obtained through a sale in the market and the repurchase obligation as expressed in SDRs, the Fund would have a claim on the former member for compensation for any loss. Consequently, the full extent of a loss will only be known when the former member fails to compensate the Fund for such difference in value.

c. If the Fund finds that, in its opinion, a loss is probable in the future, it must establish a provision against that future probable loss. The establishment and the building up of a provision would not interfere with the principles of valuation and maintenance of value since a loss could only occur after withdrawal. The Fund could start provisioning whenever the loss becomes probable. The finding of probability of a loss and consequently a decision on provisioning would not have to wait until the withdrawal has become effective. Moreover, the Fund has already strengthened its precautionary balances in light of existing overdue financial obligations. A loss subsequent to withdrawal would be charged against these precautionary balances in the Special Contingent Account, against annual income, and ultimately against reserves (special and general).

d. To the extent that unpaid charges gave rise to deferred income and were compensated by other members under burden sharing, a distribution would only be made when and to the extent overdue charges are paid.

1/ See "Valuation of Assets in the General Resources Account--Provisioning and Write-Off--Legal Considerations" (SM/86/106, 5/16/86), which outlines the main considerations regarding valuation, maintenance of value, and the concept of loss within the Fund.