

INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 89/100

10:00 a.m., July 27, 1989

R. D. Erb, Acting Chairman

Executive Directors

Dai Q.

E. T. El Kogali  
E. A. Evans

M. Finaish  
M. Fogelholm  
M. R. Ghasimi

A. Kafka

Mawakani Samba  
Y. A. Nimatallah

Alternate Executive Directors

C. Enoch

C. S. Warner  
J. Prader

M. Hepp, Temporary  
G. Garcia, Temporary  
S. Appetiti, Temporary

B. Goos  
E. Kiriwat  
L. E. N. Fernando

W. N. Engert, Temporary  
C. V. Santos

D. Marcel  
G. P. J. Hogeweg  
N. Adachi, Temporary

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

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Also Present

African Department: A. B. Taylor. Exchange and Trade Relations Department: L. A. Whittome, Counsellor and Director; J. T. Boorman, Deputy Director; T. Leddy, Deputy Director; R. G. Kincaid, S. Tiwari. External Relations Department: S. W. Kane. Legal Department: F. P. Gianviti, General Counsel; W. E. Holder, Deputy General Counsel; H. Elizalde. Middle Eastern Department: L. Alexander. Treasurer's Department: G. Laske, Treasurer; D. Williams, Deputy Treasurer; D. Berthet, Z. Farhadian-Lorie, S. J. Fennell, P. S. Ross. Western Hemisphere Department: J. E. Leimone. Office of the Managing Director: A. K. Sengupta, Advisor; P. Shome. Advisors to Executive Directors: M. Al-Jasser, S. M. Hassan, J. M. Jones, J.-L. Menda, A. Napky, F. A. Quirós, D. C. Templeman, R. Wenzel. Assistants to Executive Directors: G. Bindley-Taylor, Di W., T. T. Do, S. K. Fayyad, S. Gurumurthi, M. A. Hammoudi, A. Iljas, M. E. F. Jones, G. Montiel, N. Morshed, C. Schioppa, M. J. Shaffrey.

1. OVERDUE FINANCIAL OBLIGATIONS - PROCEDURES FOR DEALING WITH MEMBERS IN ARREARS

The Executive Directors considered a revision of the statement by the Treasurer on the Fund's procedures for dealing with members with overdue obligations, prepared in light of the discussion at a previous meeting (EBM/89/93 and EBM/89/94, 7/19/89). <sup>1/</sup> They also had before them a staff paper on the legal aspects of censure or declaration of noncooperation (EBS/89/128, 6/26/89), a staff paper on the issue of suspension of membership (SM/89/127, 6/28/89), and the six-monthly report on overdue financial obligations to the Fund (EBS/89/133, 6/29/89).

The Acting Chairman noted that an issue that had come up at the previous meetings but that was not mentioned in the revised statement on the Fund's procedures--the prospect of further staff work on the implications of a member being in arrears at the time of an SDR allocation--would need to be referred to at an appropriate place.

Mr. Goos said that he wondered whether, from a procedural point of view, the discussion had not advanced to a stage at which only the outstanding issues underlined in the revised statement of the staff could be taken up, so that general statements on the arrears strategy as a whole need not be repeated. An effort to resolve as many of those issues as possible could facilitate the process of coming to a conclusion, if not to the final conclusion itself.

Mr. Kafka said that he had in mind a similar procedural suggestion that should have the result sought by Mr. Goos, namely, to take up the revised staff statement, paragraph by paragraph.

Mr. Nimatallah said that the statement as a whole was acceptable to him, although he would have two points to raise relating to the final paragraph on the option of compulsory withdrawal and on the revised draft declaration on censure or noncooperation in Attachment III. First, there was no indication in the final paragraph of the statement of possible procedures beyond the issuance of the declaration, and he asked the staff to consider the need to mention compulsory withdrawal as a further step. As for the draft declaration, the revised text omitted the reference that had been included in EBS/89/128 to members not having adopted policies that would ensure the discharge of their obligations, thereby failing to cooperate with the Fund. The staff might wish to consider restoring such a reference.

Mr. Fernando made the general comment that whether the procedures outlined in the staff statement were of a preventive nature or of a remedial character, they should be applied only in instances of overdue obligations that were not technical arrears. The staff could perhaps clarify whether it was possible to differentiate between technical

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<sup>1/</sup> Reproduced in Annex.

arrears--for instance, repurchases delayed owing to the lack of acceptable currencies or to communications difficulties--and other overdue obligations, especially as the determination to send the first communication from management to the member had to be made when an obligation had been outstanding for two weeks only.

It would also be helpful to have further clarification of the nature of the statement, Mr. Fernando said. Was it a summing up on the general issue of the Fund's procedures for dealing with members with overdue obligations, and would it be the basis of a report to the Interim Committee?

The Acting Chairman responded that as he had indicated in his concluding remarks at EBM/89/94, the objective was to arrive at a document that could serve two purposes. First, it would be a useful, succinct statement of the Fund's policies and procedures for dealing with members with overdue obligations that would serve as guidance for the Executive Board and members. Second, it could form the background for a report to the Interim Committee on the outcome of the Executive Board's deliberations.

Mr. Hogeweg reiterated the view of his chair that the set of procedures under discussion should have broad support in the Board. As Mr. Posthumus had emphasized at the previous meetings, the package was meant to act as an effective deterrent, which meant that it should be so strong that no new cases of arrears would arise to which it would have to be applied. It was necessary to avoid the impression that procedures were being devised for dealing on a more or less permanent basis with cases of arrears as long as countries continued to have debt problems. Therefore, it was in no one's interest to dilute the package and its effectiveness as a deterrent. That philosophy could have been stated much more forcefully than it had been, if a few words were added in the introduction.

His other general remark also related to a point that had been made previously by his chair, Mr. Hogeweg added. No reference was made in the statement to the financial consequences for the Fund itself of the proposed package of procedures. Those procedures were to culminate in the option of compulsory withdrawal of the member, which, if it ever had to be exercised, would impair the value of the Fund's claims on a member that was forced to withdraw from the Fund. While a solution to that problem did not have to be found at the present stage, it should be stated explicitly that the Executive Board, while adopting a deterrent package of policy measures, was aware of the need to deal with it if the problem of procedures had to be carried out to their full extent. Such recognition would, in his view, strengthen the package as a whole, because it would indicate the Fund's preparedness to face all the consequences.

Mr. Goos said that he supported Mr. Hogeweg's second general point.

Mr. Marcel observed that if the procedures were to be an effective deterrent, some degree of uncertainty on the way in which the Fund would

handle each individual case as it arose should be maintained. Yet it was noted in the staff statement that "for remedial measures to be an effective deterrent, they would need to be clearly defined in advance...." The view of his chair was that the case-by-case approach should be applied without rigid or pre-established rules and without standardized procedures that would become routine. In addition, he questioned the usefulness of discussing at length and in great detail the timing and the wording of the procedures to be followed.

The Acting Chairman noted that the various points that had been made would be taken up when the relevant paragraphs of the statement were discussed.

The Executive Directors then considered the revised staff statement, paragraph-by-paragraph.

Mr. Hogeweg observed that the third introductory paragraph, as revised, was a rather weak reflection of the position of his chair, which he had just outlined. While the text as a whole contained all the relevant points, they had not been pulled together in a strong enough way. However, he did not know how widely that view was shared in the Board.

After a brief discussion, the Executive Directors agreed to retain the three introductory paragraphs without change.

Mr. Kafka considered that it was necessary to spell out more clearly the reference in the paragraph on arrears prevention to the possible need for seeking special understandings with creditors and donors in certain cases to help assure progress toward external viability.

Mr. Fernando said that the same comment applied to the subsequent sentence, referring to the use of specific financial or administrative arrangements in some cases, designed to ensure that forthcoming obligations to the Fund were settled on time.

The Director of the Exchange and Trade Relations Department, responding to Mr. Kafka's question, said that there were cases of members approaching the Fund for support of a program even though, without special action from creditors and donors, medium-term balance of payments viability was not achievable. Indeed, in the past, programs on the verge of such a situation had been brought to the Executive Board and approved. The staff had considered it useful to remind both itself and members that that practice was basically undesirable and that the most specific commitments possible should be sought from creditors and donors to ensure that, in the circumstances envisaged, the financing gap could be covered before a program was brought to the Executive Board for its formal approval.

Mr. Kafka said that while that seemed to be a perfectly acceptable position, it meant to him that the Fund would normally seek financing assurances, but without excluding the possibility of approving stand-by

arrangements without financing assurances when that was deemed appropriate. In other words, he asked whether a new rule was being introduced or whether the existing one would be retained.

The Director of the Exchange and Trade Relations Department replied that the staff had not been thinking of rules but of a more careful application of the practice under which programs had sometimes been put forward for which financing had not effectively been ensured. It might still be possible in certain cases to put forward programs for approval without such financing.

The Acting Chairman added that there would be times when the medium-term balance of payments prospects remained very difficult for a country. There might be financing assurances for the period of the program, but, given the magnitude of debt and repayments falling due over the medium term, understandings might have to be reached with donors and official creditors on how they would respond in the future if at some stage a heavy debt burden had to be dealt with to ensure an improvement in medium-term viability and to provide assurance that the Fund could be repaid.

The Treasurer remarked that the specific financial or administrative arrangements, to which Mr. Fernando had referred, had been used and applied for a number of years. The staff had sought to make voluntary arrangements with countries that had a record of technical difficulties or had involuntarily or inadvertently made payments late with the objective of assuring timely settlement of obligations. Those technical or administrative arrangements were of three kinds. First, an understanding was reached with the country to keep a sufficient amount in its SDR account to cover forthcoming maturing obligations, in the General Resources Department and in the SDR Department, that had to be met in SDRs. A second, technical arrangement was a standing order from countries to debit maturing obligations to their SDR accounts. Third, countries had been offered assistance in acquiring SDRs in the appropriate amount before an obligation to the SDR account fell due.

In response to a question from Mr. Warner, the Treasurer confirmed that such specific financial or administrative arrangements also included the special provisions for dealing with a member that had just settled arrears and for which new credit facilities were being established.

Mr. Warner asked whether he was correct in understanding that the Fund, in its effort to pay careful attention to access levels and phasing, to make explicit assessment of a member's capacity and willingness to repay the Fund, and to obtain adequate assurances of external financing during the Fund arrangement, would also provide sufficient detail on the reserve position and particularly capital flows. Part of what his chair had often referred to as an early warning system would be the ability of the staff, in the course of its standard auditing procedures, to draw the Board's attention, at the appropriate moment, to the possibility of a problem case.

The Director of the Exchange and Trade Relations Department confirmed that all such relevant information would be provided.

The Executive Directors then turned to the section on the revised statement on the Fund's response to overdue obligations.

Mr. Goos considered that the proposal to send a communication to Governors as soon as six weeks after the emergence of arrears continued to pose difficulties for him. One of his concerns had been met because the revised statement envisaged that there would be a meeting of the Executive Board to consider whether a communication should be sent, but in his view, there was a risk of such letters being dispatched when arrears that were of a technical character only emerged and thus of too frequent recourse to Governors. He suggested that the communication should be sent on the occasion of the Board's first substantive consideration of the Managing Director's complaint. Furthermore, he maintained his view that the letter should be written not to a selected group of Governors but to all Governors of countries that were current with the Fund. The main remedial impact of such letters could be expected to derive from the awareness of Governors of the situation; therefore, the more Governors that received such a letter, the greater the impact.

His proposal with respect to the timing of the communication would necessitate removing the underlined sentence in the paragraph on action taken when an obligation had been outstanding for two weeks to the end of the paragraph referring to the longest overdue obligation of six weeks. The underlined paragraph on the procedure for communication and convening a meeting of the Board would follow the paragraph on the issuance of a complaint by the Managing Director.

Mr. Kafka said that he agreed with the proposal of Mr. Goos on the timing of the communication. However, he had no difficulty with retaining the underlined sentence in the paragraph on obligations that had been outstanding for two weeks, because he interpreted it as not prejudging the question of who sent the communication--the Executive Director at the behest of the Board, or the Managing Director. As to the reference at the end of that paragraph to the Managing Director having on occasion raised the matter of overdue financial obligations directly with the head of government of the member concerned, as he understood it, the Managing Director had not done so without informing the Executive Director concerned.

The Acting Chairman commented that the possibility of contact with a head of state without the Executive Director having been informed previously should not be precluded. There had been occasions when a head of state had directly contacted the Managing Director.

Mr. Kafka remarked that he was seeking assurance that the Managing Director would not take the initiative to contact a head of state without seeking the advice of the Executive Director. Such direct contacts led only too easily to misunderstandings and, in at least one instance of



which he was aware, to great difficulties in arriving at a successful conclusion to negotiations between a member and Fund management and agreements that could be carried out effectively.

The Acting Chairman responded that the Managing Director was very sensitive to the complexities and the possible problems of communicating directly with the national authorities of member countries--finance ministers and central bank Governors--not to mention the head of state. The Managing Director had no intention whatsoever of creating difficulties for Executive Directors. The wording in the staff statement described the practice to date of the Managing Director in conducting his relationships with members. To the extent that communication with the head of state was involved, the Managing Director was very much aware of the sensitivity of Mr. Kafka and, no doubt, of other Directors in that connection.

Mr. Kafka recalled that for reasons he had already explained to the Executive Board, he did not think that the Managing Director should send the communication to Governors. Rather, the Board should ask each Executive Director to send such a communication to each of his Governors. A communication from the Managing Director was likely to become known to the press, unlike that from an Executive Director. The result would probably be to create embarrassment for the Governor concerned as well as for the country involved. Consequently, he urged that no such communication be sent. If the Executive Board nevertheless decided that communications to Governors should be dispatched, he would wish his objection to be formally noted in the record.

Mr. Enoch said that he supported Mr. Goos's views on the advisability of a universal communication. As the effect was meant to be partly deterrent, the wider the communication was, the more effective it would be.

As for the timing of the communication, as he understood it, the early letter went only to the Governor for the member concerned; that letter should of course be dispatched as early as possible. But there seemed to be no harm in warning the member at that stage of the possibility of a communication to other Governors concerning the situation, although he could agree with Mr. Goos that such a letter should not be sent until the Executive Board had had a substantive discussion of the matter. He could therefore go along with the drafting suggestion of Mr. Goos in that respect.

Mr. Goos said that if the sentence warning the member of the possibility of a communication were to be retained in its present place, it might be advisable to delete the word "shortly," since it would be another two months, at least, until the Board gave the matter substantive consideration.

Mrs. Hepp said that she supported the proposal of Mr. Goos on the timing of the first letter. As the proposal was worded in the revised

staff statement, management would be referring to the possibility of communicating with certain Governors before the Executive Board had been notified of the overdue obligations.

Mr. Fernando said that he shared the concerns expressed by previous speakers, in particular that of Mr. Goos with respect to the timing of the communication. It would be inappropriate for any communications to members to refer to the Executive Board before the Board had had a chance to consider the matter in depth. As it stood, the proposal seemed to be that the letter to certain Governors would be sent six weeks after the arrears first emerged, prior to the issuance of a complaint by the Managing Director two months after the obligation became overdue, and three months prior to substantive consideration by the Executive Board of that complaint. The Executive Board would only have been notified one month after the obligation had become overdue; it would not have had an opportunity to discuss the matter. More generally, he agreed with Mr. Kafka that the communication should emanate from the Executive Director concerned to the Governors of the members in his constituency.

Mr. Nimatallah considered that notification to the Board, rather than a discussion, was all that was needed prior to the dispatch of the communication.

Mr. Fogelholm asked what the general timing would be if the first communication to Governors was dispatched following the issuance of the complaint, and in particular, how long it would be before a declaration of ineligibility was issued.

The Treasurer replied that under the procedure as outlined in the revised statement, the communication from the Managing Director to Governors would be sent about six weeks after the arrears had arisen. Under the proposal made by Mr. Goos, the communication would be sent three months after the arrears had arisen. He had understood from the previous discussions, that the Board wished to alert the membership at a significantly earlier stage, excluding cases in which the delay in repayment was exclusively or primarily related to technical difficulties. The objective was to avoid the need for the Managing Director to issue a complaint for substantive consideration by the Executive Board and to eliminate the arrears at a very early stage before they became too difficult to eliminate. As for declarations of ineligibility, in the past, and depending on the circumstances, they had been issued following intervals that varied from six months to twelve months or even much longer.

Mr. Fogelholm remarked that although a communication might not be as effective if it were sent too close to the point of declaration of ineligibility, there did seem to be sufficient leeway for a communication to have an effect prior to the issuance of that declaration.

Mr. Nimatallah reiterated that the idea was to move to an approach, largely on the part of management and staff, under which as early as possible a warning would be given to the member to act to deal with its

arrears. To wait until three months had passed to issue the communication would not represent a sufficient change from the existing procedures. He urged Mr. Goos to accept the idea of an early warning approach, which had been the starting point for the present discussion.

Mr. Goos stated that in his view, the Board of Governors should not be involved from the outset, without having had the benefit of a substantive discussion of the case in question in the Executive Board. That was why he had proposed a more staged, remedial approach, under which management would first notify the country of the problem; second, the Board would give substantive consideration to the matter; and third, the Managing Director would send a letter to Governors.

Mr. Mawakani said that his position was similar to that of Mr. Kafka and Mr. Fernando as far as the communication to Governors was concerned.

Mr. Kiriwat commented that he agreed with Mr. Goos that the matter of overdue obligations should be discussed in the Board before the Board of Governors were involved. However, he could go along with a communication to selected Governors.

Mr. Evans remarked that it would be regrettable if the Fund had to delay such a communication until three months after the emergence of arrears. Nonetheless, the point that had been made with respect to not involving Governors before the Executive Board itself had undertaken a substantive consideration of the issue had considerable weight. Under the sequence presented in the staff statement, the Board would be required to agree upon a letter without having made a substantive review. Reluctantly, he thought that the communication would be better placed if it followed that first review. No Executive Director would be prevented from taking up the matter bilaterally with any Governor in his constituency that might be able to offer help. One alternative way of bringing the attention of the member in arrears to the fact that the Managing Director might consider the possibility of communicating with Governors of the Fund, would be to inform that member, after an obligation had been outstanding for two weeks, not of the possibility of communication with Governors of the Fund but of the full panoply of the procedures for dealing with members with overdue obligations to the Fund, as set out in the revised statement.

Mr. Ghasimi said that he had no major difficulty with communications to certain Governors or to all Governors. He understood that the Board would discuss individual cases in detail and would be exercising judgment in deciding to send such communications. However, he had certain difficulties with involving national or international financial agencies in the communication because they might have different objectives and motives than Fund Governors. The persuasion to be exercised by Governors--either all of them or a selected few--might be nullified by the efforts and intervention of national and international financial agencies.

The Treasurer explained that the intention was to send the first communication following the emergence of arrears to Governors only. It was the second communication that it was proposed should go also to heads of international financial institutions.

Mr. Ghasimi observed that the draft first letter to selected Governors, in Attachment I to the staff statement, made reference in the last paragraph to obtaining assistance from the government and the financial agencies of the country's government in encouraging the overdue member to resolve their arrears problem.

Mr. Hogeweg remarked that given his inclination to emphasize the preventive nature of the whole package, he would regret delaying the communication. The point made by Mr. Goos that the Board should first have a substantive discussion of the arrears that had emerged would carry greater weight if the first letter were being sent to the full Board of Governors. If the letter was sent only to a selected list of Governors of those countries that the Fund considered might be of assistance in preventing the emergence of arrears, the procedure outlined by the staff, which also made provision for Board discussion before the letter was mailed, would be quite acceptable to him.

Mr. Adachi said that he was inclined to go along with Mr. Hogeweg on the dispatch of the communication to selected Governors only. It might cause some confusion in capitals to involve Governors of countries that had no relations with the countries in arrears to the Fund.

Mr. Warner remarked that, as he recalled, the Managing Director had indicated, in connection with the possibility of his dialogue with heads of state, that the Governor of the member state concerned should certainly be made aware--whether orally or in writing--of an arrears problem before the Managing Director had contact with the head of state.

He had some reservations about the use of the word "shortly" in the references to a communication to the Governors of the country in arrears and to a complaint being issued unless payment was received, Mr. Warner remarked. He recognized that the staff wanted to keep some flexibility in the wording with respect to the period of time within which it would react to a country's failure to make a payment, but the word "shortly" was not sufficiently definitive.

Mr. Dai stated that in light of the different political and administrative systems of member countries and of their different policies in handling their bilateral relations with other countries, it would be appropriate to send the communication only to selected Governors, and with the concurrence of the countries concerned, without recommending any specific course of action to the recipient countries.

His position on issuing a declaration of censure or noncooperation remained unchanged, Mr. Dai said. His chair was not in favor of it.

Mr. Engert said that his authorities were prepared to support the procedures set forth in the staff statement. He agreed with the considerations mentioned by Mr. Hogeweg. Given the importance his chair attached to the preventive aspect of the procedures, he considered that it would be regrettable to delay dispatching the first communication to Governors, which under the proposed procedures would take place some six weeks after the arrears first emerged. If the decision to send the communication were accompanied, as he understood it would be, by an informal Board discussion, the priority to which Mr. Goos attached importance--of Board discussion and consideration of the issue before the letter was sent to Governors--would be respected.

Mr. García said that although his chair had expressed agreement to sending communications, with the objective of avoiding a further increase of overdue financial obligations to the Fund, he had some problems with the timing proposed in the staff statement. It was not clear from the wording that the Executive Board would be informed before the communication was sent. Therefore, he proposed that the first step should be to inform the Board when a member had an obligation that had been overdue for more than one month, as at present; when an obligation had been outstanding for six weeks, it would be appropriate to communicate with the government, also as at present; but before communications were sent to selected Governors, the matter should be considered by the Board in depth.

Mr. Prader commented that although he recognized that the type of problems outlined by Mr. Goos could arise if letters were sent to Governors before the Board dealt with the matter of arrears, he recalled that most Directors had referred at the previous meetings (EBM/89/93 and EBM/89/94) to the need for an early warning signal. To dispatch a letter six months after the arrears had arisen might be too late. Therefore, he would prefer to proceed along the lines set out in the staff statement. His preference was to communicate with all Governors, and not with selected Governors.

Mr. Marcel said that he could also accept the procedure as proposed in the staff statement. He agreed fully with Mr. Hogeweg, Mr. Prader, and Mr. Engert that it was important to react quickly.

Mr. Enoch said that he too could live with the wording as proposed, but if it would help to reach a consensus, it might be possible to conceive of a two-stage process. The Executive Board could first meet informally, after six weeks, thereby giving Executive Directors an opportunity to communicate with their authorities. Following the substantive, formal review by the Executive Board, Governors could be included in the communication process but not at too early a stage. The idea of an early warning would be retained.

The Acting Chairman noted that there was strong support for the procedures set forth in the staff statement. However, it would be understood, first, that a letter would not be sent when the emergence of arrears was clearly a technical matter; second, that when the Managing

Director indicated in his presentation to the Executive Board that he would like to communicate with Governors, it would be discussed at that time whether a selected group of Governors or all Governors should receive a letter and whether that communication should be made at that particular moment or at a later stage after the Executive Board had had an opportunity to hold its first, or even a subsequent, review, if one was scheduled. In that way, the Fund would not be precluded, in appropriate cases, of making early, initial contact with countries and with Governors of other member countries where that was considered helpful as a preventive measure. As a country's arrears situation evolved over time, the action would take on more of a remedial character, and all Governors would need to be informed, following a formal consideration by the Executive Board. Perhaps understandings along those lines would help to reach a consensus.

Mr. Goos remarked that he had been thinking of a compromise solution along those lines. The only question in his mind was how the Executive Board could be expected to decide on the timing and recipients of a communication without having discussed the problem of arrears in depth. He wondered whether it would be possible to accelerate the Board's substantive consideration of the Managing Director's complaint before the Managing Director communicated with all Governors.

The Treasurer replied that that would be possible. However, the procedures as they had been established and as they were laid out in the staff statement were escalating steps. To recount those steps, two weeks after the emergence of arrears, management cabled the authorities; the Executive Board was informed one month after the arrears emerged; two weeks later, or six weeks after the emergence of arrears, the member concerned was again notified by management of its outstanding obligations, informed that they must be settled, and that a complaint would be issued if they were not. After another two weeks, the complaint was issued. The timing could be compressed so that the complaint was issued, say, one month after the emergence of arrears, in place of the notification to the Executive Board, which would then hold its substantive discussion at that time, one month earlier than at present. It would then be possible for the communication to Governors to be linked to the Board's substantive consideration one month following the issuance of the complaint or two months after an obligation had become overdue.

Mr. Goos said that he could agree with the Treasurer's suggestion for accelerating the timing because it would introduce a more effective process of escalation that would culminate in the exercise of pressure on the part of Governors at the highest possible point, which was not the case in the steps as they were outlined at present.

The Acting Chairman added that the intention was not to preclude contact with a few Governors who might be helpful in resolving a specific case of arrears. It would be for the Executive Board to reach a judgment at the time that such contact was proposed. At the same time, there might

be cases in which the whole set of procedures could be accelerated and the Executive Board could decide that a universal letter should be sent to all Governors.

Mr. Nimatallah said that he agreed that both approaches were possible.

Mr. Goos recalled that his argument was based on the understanding that the Fund would communicate with all Governors, and not only with a selected group of Governors. If the majority of the Board was for a selective communication, it might not be worthwhile pursuing the matter further.

The Acting Chairman reiterated that the set of steps should not be seen to be rigid. There should be an understanding along the lines he had suggested, that in different circumstances, an early communication to a certain subgroup of Governors, seeking their assistance, would be helpful. Should it be desirable, in a different case, to have the letter distributed universally, the Executive Board could consider the matter formally. Alternatively, the procedure could be accelerated from the outset with the letter being sent after a first formal substantive consideration by the Executive Board.

Mr. Goos commented that introducing so much flexibility into the procedures would seem to run the risk of opening up a lengthy discussion on each and every case on the appropriateness of a certain approach. His preference was for as clear-cut a procedure as possible, for the reasons mentioned also by Mr. Hogeweg.

Mr. Nimatallah remarked that the final objective was to help the countries in arrears. What was needed was flexibility and credibility. The approach outlined by the Acting Chairman would probably work better in practice than a resort to rigid rules. The Fund had the means to be flexible and it should use them, bearing in mind that the purpose was to assist countries to resolve their arrears problems.

Mr. García said that he saw no contradiction between the proposal of Mr. Goos and the views of Mr. Nimatallah. What was needed was an agreement by the Board when the letter was sent to a selected number of Governors with the intention of helping the country. If, as preferred by some Directors, the letter should be sent to all Governors, that was a matter for further discussion by the Executive Board. The two ideas could then be reconciled.

The Acting Chairman noted that many different cases could arise. Under the procedures as they had been proposed in the staff statement, the Managing Director would intend, depending on the circumstances of the case, to convene a meeting of the Executive Board prior to discussing the next step. He might propose to send a letter to a selected group of Governors, the essence of which would be discussed with Executive Directors at that time. If it was the judgment of management that a letter

to all Governors would be desirable, it was his understanding that many Directors would prefer to discuss that matter at the time of or after the Executive Board had had an opportunity to consider the Managing Director's complaint. If there was a case in which the circumstances, in the judgment of the staff and management, merited sending an early universal letter, it would be possible to accelerate the procedure and the period within which the Board took up the formal complaint. The outer limits of the period mentioned in the staff statement did not have to be applied rigidly.

Other variations of the procedure could be envisaged, but the ones he had outlined were probably the most important ways in which to achieve the necessary element of flexibility, the Acting Chairman added. It was clearly the desire of the Board to have a full discussion if a letter was to be sent to all Governors, and that desire could be accommodated in the procedures, even if it meant accelerating consideration of the formal complaint. If management judged that such an acceleration was not necessary, but that contact with selected Governors would be helpful in certain cases, then the matter would be put to the Board for discussion and the nature of the communication would be discussed with Executive Directors.

Mr. Engert asked whether the decision as to which of the two avenues the Fund would take would be made at the more informal session, to be held about six weeks after the emergence of arrears.

The Acting Chairman noted that if an informal meeting was considered to be necessary, that was the time at which the decision would be reached.

Mr. Fogelholm made the general point that while he understood the need for flexibility, given that circumstances would vary from one case to another, he nevertheless trusted that procedures would evolve over time so that similar cases could be treated in similar fashion. In other words, guidelines needed to be developed to avoid undue pressure on the Fund and the Board in any given case.

Mr. Kafka, referring to the last paragraph of the section on the Fund's response to overdue obligations, restated for the record his inability to agree, until the procedures and timing had been spelled out in detail, to the suggestion that a member must first discharge its overdue financial obligations to the General Resources Account before it would be permitted to pay for an increase in its quota under the Ninth General Review.

Mr. Fernando reiterated the position of his chair that the matter of paying for an increase in quota would have to be examined in the context of the Board's discussions on the Ninth General Review of Quotas.

Mr. Mwakani recalled that he had not supported the proposal with respect to the discharge of overdue financial obligations before a member could pay for an increase in its quota. His position had not changed, and if the paragraph as drafted was to remain in the statement agreed by the



Executive Board, he would have to ask that his reservation be recorded. After all, the inclusion of such a suggested procedure in the statement on overdue financial obligations seemed to convey the idea that nothing much was expected to result from communications to all Governors, or from having identified members with overdue obligations outstanding for more than six months in the Fund's annual report and in financial statements.

Mr. Kiriwat remarked that he too was concerned about the issue of quota payments, which should be considered, in his view, in the context of the Ninth General Review. There should be no association with overdue financial obligations.

Mr. Finaish stated that he shared the same concern as others, including Mr. Kafka and Mr. Fernando, on the question of the payment for quota increases.

Mr. Appetiti said that he wondered whether the remedial action inherent in the proposal that an increase in a member's quota would lapse, if it did not first discharge its overdue financial obligations, would apply only to the Ninth General Review or to quota reviews in general. A general reference to quota reviews would after all encompass the Ninth Review. If the Board was going to approve such remedial action, it should probably decide fairly soon on the period of time during which the payment for a quota increase could be made, thereby enhancing the corrective nature of the action.

The Acting Chairman commented that he hoped overdue obligations would be settled by the time of the Tenth General Review.

Mr. Warner recalled that the specific reference to the Ninth General Review had been included in the hope that arrears would not be a consideration beyond that review. However, he would have no reluctance to including a general statement that would cover all future quota reviews.

Remedial action with respect to payment for quota increases should be complemented by similar action with respect to SDR allocations, Mr. Warner said. He had taken note in that connection of the Acting Chairman's indication that reference would be made to the possibility of withholding SDR allocations for members with arrears in the General Department and that a staff paper would be forthcoming on the issue.

The Acting Chairman remarked that it was understood, as a result of the discussion, that a staff paper would have to be prepared examining a specific proposal for implementing the suggestion that a member first discharge its overdue financial obligations before it would be permitted to pay for an increase in its quota under the Ninth General Review, and for the increase in quota to lapse if a quota payment were not made within a prescribed period.

Reference to the possibility of withholding SDR allocations for members with arrears in the General Department would also be added to the revised staff statement, the Acting Chairman noted.

The Treasurer, in response to a question by the Acting Chairman, noted that it had been the strong hope and expectation that no arrears would remain outstanding by the time of the Tenth General Review of Quotas, which would take place five years later. By limiting the reference in the staff statement to the Ninth General Review, greater incentive would be given to members in arrears to clear them before the time for making subscription payments for quota increases under the Ninth General Review elapsed.

Mr. Warner considered that it would be necessary, in case arrears remained on the Fund's books upon the completion of the Ninth General Quota Review, either not to refer to the Ninth General Review at all or to refer to the Ninth General Review or any subsequent review.

The Deputy Treasurer commented that one difficulty with deleting the reference to the Ninth General Review from the first part of the paragraph under discussion was that the second part of the paragraph might not necessarily apply in all quota reviews. Also, there might be ad hoc quota increases, between reviews. The proposal that a member's quota would lapse, in the event of nonpayment of the subscription within a prescribed period, was for discussion in the context of the Ninth General Review. In addition, it should be noted that it was not only the quota payment that was within the discretion of the Executive Directors but the period of consent, which could be extended, if the Resolution adopted by the Board of Governors on the increase in quotas under the Ninth General Review provided for such an extension on the recommendation of the Executive Board. In that case, payment would usually follow 30 days after a member had consented to an increase in its quota.

In response to a comment by Mr. Enoch, the Deputy Treasurer explained that a member that settled its overdue obligations to the General Resources Account only after the Ninth General Review took effect, might then request the increase in its quota that it would otherwise have received under the Resolution on the Ninth General Quota Increase. The question to be decided was whether such an ad hoc increase that fell outside the Ninth Quota Review should be accommodated. Likewise, a member could fall back into arrears during the period of consent, and a similar decision on the application of the procedure for letting an increase in quota lapse would have to be taken.

The Acting Chairman remarked that it was clear that the Executive Board would need to have a detailed proposal before it in order to be able to indicate a position on the withholding of a quota increase from a member. He suggested that the paragraph of the staff statement under discussion be retained in its present form until the staff had prepared a paper for detailed review by the Executive Board of the complex issues

arising out of cases of members in arrears to the Fund in the context of the Ninth General Quota Increase. General guidelines could be drawn up following such a review.

The Executive Directors then considered the draft first letter to selected Governors in Attachment I to the staff statement.

Mr. Enoch commented that as drafted, the letter bore a greater resemblance to one destined for all Governors. If selected Governors were to receive a separate letter, it should state much more specifically why those Governors were being addressed and what was expected of them. It might be helpful also to refer in the first paragraph, which did imply universality, to the prospect of ineligibility, thereby adding substance to the content and indicating the Fund's next possible step.

Mr. Goos remarked that the modified paragraphs in the staff statement relating to the first letters explained only how the procedure for communicating with selected Governors would be implemented. The procedures for sending the general communication would have to be mentioned also.

He could support Mr. Enoch's suggestion to include a reference to ineligibility in the first draft letter, to identify one of the subsequent stages in the procedure, Mr. Goos added.

Mr. Warner said that he also could support Mr. Enoch's suggestion to refer to ineligibility.

Mr. Fogelholm remarked that while he would have no problems with including a reference to ineligibility in the draft letter, he had difficulties with stating that Governors were expected to react and how. It should be left entirely open to Governors to take whatever action they wished, or none at all.

Mr. Kafka stated that while he maintained his objection to any communication being sent by the Managing Director--his preference being for the letter to be sent at the behest of the Board through individual Executive Directors--it would be premature to insert any reference to ineligibility in such letters. To start with such a threat could lead to piling on other threats, such as that of compulsory withdrawal, which would not be helpful.

The Acting Chairman suggested that the concern of Mr. Goos could be met by modifying the underlined paragraph that it had been proposed should be added to the section on the Fund's response to overdue obligations to better reflect the understandings that he had outlined. The text would explain not only why the Managing Director was raising the issue with a selected group of Governors, and convening a meeting of the Executive Board to consider the issue, but also that the Board would consider the possibility of sending a communication to all Governors, along the lines of the draft letter in Attachment I, it being understood that there should have been a formal review by the Board of the case, bearing in mind also

that it would be possible for the Board to hold such a review before the end of the three-month period subsequent to the emergence of the arrears.

Mr. Fogelholm commented that the two letters should be considered as substitutes or alternatives; otherwise, it would seem as if an additional third letter was being introduced into the procedures.

Mr. Enoch said that he supported Mr. Fogelholm's point with respect to the two letters being substitutable in individual cases. It would be counterproductive to send a letter to selected Governors in the first place and a further letter to all Governors at a later stage.

Mr. Dai suggested that the Board should first decide what guidelines it would follow in deciding whether the letter should be to selected Governors or to all Governors.

Mr. Goos remarked that he felt sure that the staff would find appropriate wording to avoid any misunderstandings about the nature of the two letters.

The Acting Chairman stated that the text would be revised to make it clear that any letter that was dispatched to all Governors would follow a formal Board meeting along the lines of the procedure that he had outlined. That formal discussion might not be the first review by the Board. In addition, the Board would decide, when it considered the circumstances of the case, whether or not to mention the possibility of the declaration of ineligibility.

The Executive Directors then turned to the section of the staff statement on the declaration of ineligibility.

Mr. Enoch considered that only the first sentence of the third paragraph--stating that remedial measures would be applied to members judged not to be cooperating actively with the Fund--need be retained. First, those measures were self-explanatory, and second, the intensified collaborative approach should not be mentioned in the same context. Not all members in arrears would wish to benefit from the intensified collaborative approach; and some would manage to solve their problems by their own efforts, with bilateral assistance. The collaborative approach was an exceptional one.

Mr. Goos and Mr. Warner indicated that they could support Mr. Enoch's suggestion.

Mr. Kafka reiterated that he also objected to the further communication in Attachment II that would be sent by the Managing Director after a member had been declared ineligible. Rather, it should be sent by the Executive Director at the behest of the Executive Board. In addition, he objected particularly strongly to sending such a letter to institutions, which were likely to react in the light of their own special problems and interests--much as the Fund had to the numerous communications it had

received over the years from the United Nations. If letters were to be sent to Governors, who after all were part of the Fund, he hoped with a signatory different from that of the Managing Director--all well and good, but to send them to other institutions would to say the least not be helpful to the member country in arrears, because it would be subjected to collective victimization.

Mr. Nimatallah commented that the idea was to provide information to other international organizations on countries that had protracted arrears to the Fund. Whether or not those other international organizations took any action was up to them. At the very least, they should be informed that a few Fund members were not cooperating with the international community.

Mr. Warner remarked that Mr. Nimatallah had covered the point well. He would add only that it had been his understanding that the world community looked to the Fund for the critical first findings on a country's financial status. Therefore, for the Fund to have made a determination as serious as ineligibility to use its resources and thereafter hide the fact did not render much service to those in the world that had to take decisions on credit or related substantive issues. The notification process that was envisaged could serve the system well. If, as he believed, the concern about sending communications to other international organizations stemmed from the fear of decatalyzation, there was no escaping the fact that sooner or later the world would be fully informed. A communication along the lines suggested would not represent broad publicity but would contain information of which the pertinent institutions that relied on the Fund's judgment should be aware of.

Mr. El Kogali stated that his chair, which was supportive of any preventive measures, remained skeptical about all remedial measures. To involve other international institutions would lead to charges of "smear campaigns"; there had indeed been one such charge in the past, and it had taken a great deal of effort on the part of the Fund to clear it. Declarations of ineligibility were already made public. Letters to international institutions carried the implication that action was expected of them, and they would be counterproductive, unless of course the Fund stood ready to write off the arrears. Such communications also added another dimension to the concept of cross-conditionality. Either the Fund wanted to help its members, to encourage them to cooperate with it, or it would impose punitive measures that defeated the very purpose of the collaborative approach.

Mr. Goos said that his authorities also had reservations about sending a second letter to international institutions for fear of being asked to be of reciprocal assistance. However, sending such letters to the World Bank and to regional development banks would be acceptable.

Mr. Kiriwat remarked that he had not been convinced that sending a letter was the best way to inform other institutions. If necessary, informal contact between the Fund and such institutions might be more useful.

Mrs. Hepp said that she fully shared Mr. Kiriwat's views.

Mr. Garcia said that he too considered that sending the letter to international financial institutions might worsen rather than improve an arrears situation.

Mr. Appetiti said that his position was similar to that of Mr. Goos. He had no problem as long as the letter was sent to selected financial organizations.

Mr. Evans said that he too had reservations about sending the letter to international financial institutions, recognizing that some of them may have contributed to the problems of the member in arrears. However, he also saw some benefit, and he wondered whether a compromise might be to send the letter to the financial institutions purely for information, whereas the letter to Governors would, as proposed, seek their assistance.

Mr. Prader said that he was inclined to share the point of view of Mr. Goos. A letter for purely informational purposes was not very useful because the declaration would already have been published.

Mr. Fogelholm commented that he could go along with the proposal of Mr. Goos to limit the recipients to the World Bank and the interregional banks.

Mr. Nimatallah, Mr. Hogeweg, Mr. Warner, Mr. Adachi, and Mr. Engert said that they too could accept the suggested amendment by Mr. Goos.

Mr. Ghasimi said that he had the same concern with respect to the draft second letter in Attachment II as he had with the letter in Attachment I. The communication asked all Governors to take whatever actions they considered appropriate, and then went on to specify such actions, including informing relevant financial agencies of their country of the failure of a member to fulfill its financial obligations. While that might be helpful in some cases, in others it might have a decatalyzing effect on the mobilization of financial resources that were indispensable for the country in arrears. As a matter of fact, the efforts by the Governors themselves to resolve the issue by persuading the Governor of the overdue country to become current might be thwarted. He suggested that reference to specific actions be eliminated, leaving it to the Governors to decide whether it was appropriate to inform their national agencies of the situation.

Mr. Goos recalled that his authorities had previously expressed their reservations against any such second letter. Their main concern was that the instrument might lose its effectiveness, leading to a declining

readiness on the part of Governors to respond to the flood of letters in the pipeline. His authorities wished to have their objection to sending such a letter recorded in the minutes.

Speaking personally, Mr. Goos said that he wished to repeat the suggestion he had made at the previous discussion, namely, that the thrust of the letter be changed fundamentally so that it became basically a piece of information on what the Fund might have to do if the country did not become current in its obligations to the Fund. As Mr. Ghasimi had proposed, the specific request to Governors for assistance should be deleted, as should the reference to the intensified collaborative approach. The letter would then consist of the first three short paragraphs, together with the statement of fact in the sentence reading "If, in the period prior to the next review of (member's) arrears, (member) does not take action to demonstrate its willingness to resume active cooperation with the Fund toward the resolution of the problem of its arrears, (member) may be subject to a declaration of noncooperation. This would be a most serious step that could lead to the consideration by the Executive Board of procedures leading to compulsory withdrawal of (member) from the Fund." The request to Governors for their general assistance was incorporated in the final paragraph, which would be retained, although the last sentence of that paragraph, which was in square brackets, and which asked for the benefit of Governors' views on the matter, should be deleted.

Mr. Enoch said that he fully supported the suggested amendments and deletions proposed by Mr. Goos.

Mr. Fernando stated that he also supported the suggestions by Mr. Goos, in the sense that he had reservations about the fourth paragraph of the second letter in Attachment II as it had been revised. To reiterate, he could not agree to including references to the possibility of a declaration of noncooperation or eventual compulsory withdrawal. Those steps would be purely punitive and premature in the light of inadequate experience with the intensified collaborative approach, as well as inconsistent with recent developments in dealing with the private commercial debt of low-income countries.

Mr. Kafka asked whether it would not be advisable to maintain a reference to the intensified collaborative approach.

Mr. Goos responded that, for the reasons mentioned by Mr. Enoch, the intensified collaborative approach would not be appropriate in all cases. Furthermore, his personal concern was that explicit reference to the intensified collaborative approach might well lead to problems of moral hazard. The country might state that it was prepared to take whatever action was requested of it, as long as it received the financial resources up front, whereas it should, on the contrary, first show its readiness and willingness to come to grips with its economic problems by initiating adjustment measures. The country should not be given an excuse not to do so because there was no immediate readiness to provide financing. The

intensified collaborative approach should be applied, at the very least, on a case-by-case basis, to avoid any such problem of moral hazard.

Mr. Kafka considered that the fundamental problem was the likelihood of the collapse of the intensified collaborative approach, which so far had been applied to only one country. While he could understand the difficulty of Mr. Goos, it could be met easily by inserting wording to the effect that the country in arrears should avail itself, where appropriate, of the possibility of the intensified collaborative approach. Without that approach, the arrears problem would never be solved. The objective was to solve it, and not to punish or, still less, to exhort countries pointlessly.

Mr. Fogelholm said that his chair remained skeptical about the value of the second letter; he could thus understand the views of the German authorities. However, he could accept a letter along the lines suggested, if that was the general view and if the specific link between the declaration of noncooperation and compulsory withdrawal was not made; the implicit threat was ineffective.

Mr. Kiriwat said that he shared Mr. Fogelholm's view on the inappropriateness of referring to the possibility of compulsory withdrawal in the draft second letter, as well as in the draft declaration of censure and noncooperation. That option should not be discussed at that stage of the procedures.

Mr. Dai agreed that the reference to compulsory withdrawal should be deleted.

Mr. Nimatallah considered that the communication would become ineffective with the amendments and deletions that had been proposed. He could understand the concern of both Mr. Ghasimi and Mr. Goos about the specific action expected of governments by the Fund, and he could go along with deleting the reference to informing relevant financial agencies. However, it was helpful to mention the intensified collaborative approach, which after all would be applicable only to a few countries with protracted arrears. The collaborative approach, of course, preceded the declaration of noncooperation, but it was nevertheless useful to emphasize the benefit that a country could derive from that approach as well as to refer to what could happen if it did not take advantage of it. The main purpose of the second letter should be to note that a member country was not cooperating with the Fund, that it ran the risk of being declared in a state of noncooperation, with harmful consequences, but that the intention was to help it avoid that path.

Mr. Engert said that he agreed with Mr. Nimatallah that it would be helpful, for the small number of countries concerned, to indicate that the best solution to their problems was the intensified collaborative approach. Therefore, he could go along with the retention of the two sentences on the intensified collaborative approach. Like Mr. Fogelholm, however, his preference would be not to indicate any link to compulsory



withdrawal in the second letter. He also agreed with those who had indicated a preference to delete the request to Governors to give the Fund the benefit of their views. The Executive Board would provide those views in due course.

Mrs. Hepp said that her chair wished to delete all the underlined wording in the fourth paragraph of the draft second letter. The usefulness and the effectiveness of the two remedial measures--declaration of noncooperation and compulsory withdrawal--had not been established.

Mr. Hogeweg remarked that the effectiveness of certain sentences was a matter of judgment, but the extensive deletions that had been proposed confirmed the fears that he had expressed at the beginning of the meeting. It was of vital importance to consider the whole series of measures as a deterrent; if the measures were weakened too much, the likelihood of the problem they were meant to deter only increased. He urged the Board to be aware that the stronger the package, the better it would be for everyone.

Mr. Evans, Mr. García, and Mr. Fayyad said that they supported Mr. Nimatallah's proposed amendments.

Mr. Warner said that it might be helpful if the staff could prepare a further revision of the draft second letter, in the light of the discussions.

Mr. Enoch noted that shortening the letter would not make it any less powerful. In fact, if the letter concentrated on specific points, it might become more powerful. He maintained his preference for not referring to the intensified collaborative approach because of the many uncertainties about how it was to be implemented, there having been only one successful case so far. The series of remedial measures under discussion would be part of a standard procedure that could be applied flexibly, case by case.

Mr. Prader stated that his preference was for a shortening of the letter and the deletion of the reference to compulsory withdrawal.

Mr. Marcel said that he had no objection to the proposed timing of the procedure, but in order to avoid setting rigid rules, he suggested that reference be made to such communications generally, or normally, being raised for Board consideration at the time of the first postineligibility review.

The Treasurer noted that that would introduce greater flexibility.

The Acting Chairman said that the staff would prepare a further revision of the draft second letter in Attachment II for consideration by the Executive Directors.

Mr. Fogelholm commented that the structure of the statement would be improved if subheadings were added to separate the paragraphs on, for

instance, the declaration of noncooperation and other remedial measures, such as compulsory withdrawal, in order to indicate an escalation of steps.

Mr. Finaish, referring to the three related tests germane to the decision to issue a declaration of censure or noncooperation, asked for further elaboration of the second test, relating to "an assessment of the member's capacity and willingness to service its obligation to the Fund, reflecting exogenous factors that may have affected that capacity and payments made to other creditors."

The Director of the Exchange and Trade Relations Department noted that a member's capacity and willingness to service an obligation to the Fund was a theme that had been discussed on a number of occasions. The staff had continually made the point that the distinction was difficult to draw but that there were certain tests which might indicate that the balance lay on one side or the other. However, the staff had shied away from making that a clear-cut test. The reference to exogenous factors that may have affected that capacity and to payments made to other creditors again picked up points that had been discussed several times by Executive Directors. The proposed wording did not reflect any new ideas but simply attempted to reflect succinctly points that had been put forward previously by Executive Directors for their reconsideration.

Mr. Finaish remarked that it would be useful in the future, whenever a judgment had to be reached on the reasons why countries had made payments to creditors other than the Fund, to elaborate on the motivation for the general debt-service behavior of the member in arrears. As Mr. El Kogali had mentioned, it was frequently a matter of having to repay a creditor in order to obtain essential imports. The words "reflecting exogenous factors" was also not clear in that context. Presumably, exogenous factors in general would be taken into account, including the behavior of the member in arrears toward others.

The Acting Chairman noted that the wording would be clarified and the staff would make an effort, in undertaking such an analysis, to present to the extent possible the background to the payments made to other creditors.

Mr. Goos observed that he continued to have difficulties with the presentation of the second test as a separate criterion because the elements to be taken into account fell more appropriately under the first test, that of the member's performance in meeting its financial obligations to the Fund. He wished to stress that point because of his continued concern that the emphasis on the member's capacity to pay (combined with exogenous factors)--rather than as previously, its ability to pay--would often lead to difficulty in reaching the proper judgments. It might be a question of defining what was exogenous and what was endogenous. In addition, each and every Fund member, even the poorest members, were able to pay at least small amounts to the Fund to demonstrate their willingness to the Fund to cooperate and to normalize their situation.

Presumably, if no payments had been made either to the Fund or to other creditors, it would not automatically be concluded that, because the second test was not relevant, the member was in fact cooperating.

The Treasurer recalled that the three tests for determining whether a declaration of noncooperation should be issued had been contained in the staff paper discussed by the Executive Board (EBS/89/128, 6/26/89; EBM/89/93 and EBM/89/94, 7/19/89). The staff's understanding of the discussion at that meeting had been that there was general agreement with the three tests, which had therefore been set out in greater detail in the staff statement on procedures for dealing with members having overdue obligations to the Fund.

Mr. Nimatallah said that if the second test was not to be a separate criterion, as Mr. Goos had suggested, but a subcriterion, he wondered whether the Fund would have sufficient flexibility to deal with the problem of a country that had stated, for instance, that it was limiting its debt and debt service payments to a certain percentage of its export earnings to other creditors, excluding the International Monetary Fund.

The Acting Chairman remarked that such a case would be taken up under the first test, along the lines indicated by Mr. Goos.

Mr. Nimatallah recalled that he had requested that the declaration of noncooperation reflect the third test, relating to the preparedness of a member to adopt comprehensive adjustment policies.

The Acting Chairman remarked that that point could be taken up when the Board considered the wording of the declaration itself.

Mr. Goos said that the second criterion had been formulated in a much simpler manner in EBS/89/128. If the second test was to be retained, it would be sufficient for it to refer only to whether or not the member had made payments to other creditors while continuing to be in arrears to the Fund.

Mr. Kafka recalled that several Directors had placed special emphasis on the existence of exogenous factors. It went without saying however, that he maintained his objection to declarations of noncooperation as well as to sending communications to international financial institutions, including the World Bank.

Mr. Goos remarked that exogenous factors could still be taken into account under the first test. The important criterion was to determine whether or not the member was discriminating against the Fund, even in situations in which it was subject to exogenous factors or constraints.

Mr. Kafka said that he had no problem with changing the wording relating to discrimination as long as the reference to exogenous circumstances was retained.

Mr. Mawakani reiterated his reservation with respect to declarations of noncooperation.

Mr. Marcel commented that he shared the concern of Mr. Goos on the distinction between inability and willingness. The Fund would be in a very difficult position if it had to recognize the incapacity of a member to repay the Fund, for instance, with respect to rescheduling operations.

Mr. Prader said that he would be interested in some further clarification on how Mr. Hogeweg's point about the value-impaired status of Fund assets subsequent to the compulsory withdrawal of a member that had overdue obligations would be covered in the statement on procedures for dealing with members in arrears.

Mr. Hogeweg said that it was not clear to him at which stage of the procedures such a reference should be made. His point had been that with the statement before it, the Board would establish a series of procedures of increasing strength and of a deterrent nature. The list of steps would culminate in compulsory withdrawal. As had been agreed, and as stated in the section of the statement on the declaration of ineligibility, for remedial measures to be an effective deterrent, they needed to be clearly defined and their implementation needed to be credible. Part of that credibility would reside in the Fund's preparedness to pursue the course, if it started out on it, to the very end. In doing so in a certain case, the Fund would reach the point of initiating compulsory withdrawal even though that was not meant to be the outcome. If a member was forced to withdraw, the claim of the organization on that member became less likely to be paid than would otherwise be the case. That fact should somehow be reflected in the Fund's books, at least, that would no doubt be the view of the internal and external auditors. How to reflect that impairment of the Fund's assets and how to finance it was a matter that would have to be solved at some point, but not at the present time. He had wanted the Board only to agree, for the time being, on including an explicit recognition in the statement of the problem arising at that stage and the need to deal with it.

Mr. Nimatallah considered that the Articles of Agreement and the By-Laws seemed to provide sufficient protection to the Fund, which moreover, had had experience with compulsory withdrawal from membership that should stand it in good stead.

Mr. Prader commented that he could agree with what Mr. Hogeweg had said. Nevertheless, he was worried about the implication that certain members might find it no longer useful to participate in the intensified collaborative approach. It was thus not only a matter of how the Fund valued its assets but how members valued their Fund assets. In order not to jeopardize the intensified collaborative approach, including rescheduling, it seemed advisable to be cautious in referring to compulsory withdrawal and the implications for the valuation of Fund-related assets.

Mr. Marcel said that he fully agreed with Mr. Prader.

Mr. Nimatallah stated that the issue being brought up was a legal one. There were many ways for the Fund to collect money due to it and it was not necessary to go into them in detail in the context of the statement under discussion, thereby throwing doubt on the procedures that were being established and that were moving in the right direction.

The Treasurer recalled that in the two cases of members withdrawing from the Fund, the claims of the institution had been settled according to procedures laid down in the Articles of Agreement and the By-Laws. There had been no effects of the type mentioned by Mr. Hogeweg. If a situation arose in which compulsory withdrawal had to be considered, the Fund would, as a matter of course, have to analyze the impact on its financial position, should no satisfactory solution be found to the settlement its claims on that member in the context of negotiations on the withdrawal.

Mr. Kafka said that to the best of his recollection, neither case of withdrawal had been occasioned by arrears on the part of the member. Overdue obligations said something about the financial situation of the country that was withdrawing and might therefore say something about the ability of that country to repay the Fund.

Mr. Prader said that he agreed with Mr. Kafka that previous experience with compulsory withdrawal was not relevant in dealing with the general issue of arrears. It was important to ensure a responsible attitude on the part of the Fund.

Mr. Enoch said that he had great understanding for the point of view expressed by Mr. Prader and others. At some stage, the Board would have to look into the consequences of taking a course of action that might lead to compulsory withdrawal. His preference would be to replace the final paragraph of the statement with a factual reference to the existence of procedures under the Articles for compulsory withdrawal, without any mention of the procedures leading to such withdrawal under certain circumstances.

Mr. Prader remarked that it was a matter of judgment as to whether there was the same chance of dealing with compulsory withdrawal in the case of a member in arrears as with the two historic cases of withdrawal. He could go along with Mr. Enoch's proposed amendment.

Mr. Marcel and Mr. Warner said that they too could accept Mr. Enoch's amendment.

Mr. Engert remarked that he also agreed with Mr. Enoch's suggestion. He wondered whether the considerations that had been mentioned also suggested some modification to the declaration of noncooperation and to the communications to Governors, for the sake of consistency.

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

DECISION TAKEN SINCE PREVIOUS BOARD MEETING

The following decision was adopted by the Executive Board without meeting in the period between EBM/89/99 (7/26/89) and EBM/89/100 (7/27/89).

2. STAFF APPOINTMENT

The Executive Board approves the proposal relating to the staff appointment under Rule N-1, as set forth in EBAP/89/180 (7/12/89).

Adopted July 26, 1989

APPROVED: March 26, 1990

JOSEPH W. LANG, JR.  
Acting Secretary

Revised Statement prepared by the Staff on the Fund's Procedures  
for Dealing with Members with Overdue Obligations to the Fund  
Executive Board Meeting  
July 27, 1989

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The Fund, as a cooperative institution, relies on the mutually supportive actions of its membership in all areas of its endeavors. Overdue financial obligations are a breach of obligations to the Fund and are demonstrably a noncooperative action, which imposes financial costs on the Fund's membership, impairs its capacity to assist members, and more generally weakens the Fund's ability to perform its broader responsibilities in the international financial system.

As the experience with arrears demonstrates, countries which accumulate arrears to the Fund also damage themselves, in part through the deterioration which inevitably occurs in their financial relations with other creditors. When arrears exist the Fund is not able to provide its own assistance or serve as an effective catalyst in helping the country restore regular financial relations with other creditors.

This statement outlines the procedures aimed at preventing the emergence of overdue financial obligations to the Fund and the elimination of existing overdues, including protracted arrears. The need for flexibility in the implementation of the Fund's policies dealing with overdues has been stressed in the past, and must continue, in order to take account of the specific circumstances of the member. Nonetheless, a balance must be struck between the need for appropriate flexibility and the need for clear and credible procedures that act as a deterrent to members to incur arrears and to encourage members with overdues to become current.

#### Arrears prevention

The importance of preventing new cases of arrears has been stressed by the Executive Board. As noted in the past, our best safeguard is the quality of Fund arrangements and we will continue to direct our efforts to ensure that arrangements of the highest quality are placed before the Board. These efforts would include assisting members to design strong and comprehensive economic programs, careful attention to access levels and phasing, explicit assessment of a member's capacity and willingness to repay the Fund, and adequate assurances regarding external financing during the period of the Fund arrangement. Special understandings with creditors and donors may also need to be sought in certain cases to help assure progress toward external viability. In some cases, specific financial or administrative arrangements--designed to ensure that forthcoming obligations to the Fund are settled on time--will be used to increase the assurance that the Fund's resources will be repaid on time. Moreover, the importance of members remaining current on obligations falling due and observing the Fund's preferred creditor status would continue to be stressed.

The Fund's response to overdue obligations

The Fund has developed a set of procedures for dealing with members with overdue financial obligations which are designed to bring about a reduction and the eventual elimination of these overdue obligations. In addition to the procedures set out below, the Fund makes an effort to assist members eliminate arrears through the design and implementation of appropriate policies as well as help members adopting these policies to secure the necessary financial support.

The procedures initiated immediately after a member falls into arrears provide for a sequence of actions by management, the staff, and the Executive Board.

- Whenever a member fails to settle an obligation on time, the staff immediately sends a cable urging the member to make the payment promptly; this communication is followed up through the office of the Executive Director concerned.

- When an obligation has been outstanding for two weeks, management sends a communication to the Governor for that member stressing the seriousness of the failure to meet obligations to the Fund and urging full and prompt settlement. The Executive Board understands that the Governor will bring this communication and the circumstances that gave rise to it to the attention of his authorities at the highest level. The communication to the Governor would also note that unless payment is received shortly, the Managing Director would intend to raise with the Executive Board the possibility of communicating with certain Governors of the Fund concerning the situation. The Managing Director has on occasion raised the matter of overdue financial obligations to the Fund directly with the head of government of the member concerned, and he would intend to continue to do so in those cases where he believes it would be a useful procedure.

- The Managing Director notifies the Executive Board normally one month after an obligation has become overdue.

- When the longest overdue obligation has been outstanding for six weeks, the Managing Director informs the member concerned that unless the overdue obligations are settled shortly a complaint will be issued to the Executive Board.

- Under the procedure for communication with selected Governors, depending on the circumstances of the case, the Managing Director would also intend to convene a meeting of the Executive Board to discuss the situation. For this meeting, a proposed text of the communication to be sent to a list of Governors selected by the Managing Director would be prepared by the staff for the consideration of Executive Directors. The communication would be sent with the concurrence of Executive Directors. A sample text is set out in Attachment I.



- A complaint by the Managing Director is issued two months after an obligation has become overdue, and is given substantive consideration by the Executive Board one month later. At that stage, the Executive Board has usually decided to limit the member's use of the general resources, and if the member has overdue obligations in the SDR Department, to suspend its right to use SDRs, and has provided for a subsequent review of the decision. This and subsequent review periods would normally not exceed three months.

- The Annual Report and the financial statements identify those members with overdue obligations outstanding for more than six months.

Beyond these procedures, the Executive Board has expressed its intention to provide that a member must first discharge its overdue financial obligations to the General Resources Account before it would be permitted to pay for an increase in its quota under the Ninth General Review, and that, in the event the quota payment were not made within a prescribed period, the proposal for an increase in the member's quota would lapse.

#### Declaration of ineligibility

If a member persists in its failure to settle its overdue obligations to the Fund, the Executive Board declares the member ineligible to use the general resources of the Fund. The timing of the declaration of ineligibility would vary according to the Board's assessment of the specific circumstances and of the efforts being made by the member to fulfill its financial obligations to the Fund. The procedures for dealing with members with protracted arrears that have been declared ineligible include further reviews at intervals of not more than six months.

For members with protracted arrears willing to cooperate with the Fund in settling those overdues, the Fund has adopted an intensified collaborative approach, which incorporates exceptional efforts by the international financial community.

For members that are judged not to be cooperating actively with the Fund, remedial measures would be applied. These measures are designed to function as tangible inducements to members with protracted overdues to avail themselves of the intensified collaborative approach, while at the same time they would act as a deterrent for other members. For remedial measures to be an effective deterrent, they would need to be clearly defined in advance; the procedures for their implementation broadly endorsed; and their implementation needs to be credible.

- Members not showing a clear willingness to cooperate with the Fund have been informed that in these circumstances the provision of technical assistance would be inappropriate, but the Fund would reconsider providing technical assistance once the member has resumed active cooperation. The Managing Director may also limit technical assistance provided

to a member, if in his judgment that assistance was not contributing adequately to the resolution of the problems associated with overdues to the Fund.

- A further remedial measure in cases of protracted arrears would be communications with all Governors of the Fund and with heads of selected international financial institutions. As discussed in EBS/89/133, use of such communications would be raised for the Executive Board's consideration at the time of the first post-ineligibility review of the member's arrears. At that time the staff would prepare a draft text of a communication along the lines set out in Attachment II to this statement. It should be noted that the Fund's communication to other international financial institutions, like its communication to the Governors, would not request the addressee to take specific actions and would leave any action to the institution's discretion.

The staff would intend to propose to send this latter type of communication on the occasion of the next post-ineligibility review for members that at present have arrears that have been outstanding for a protracted period, in the event the Executive Board judges that the member concerned is not cooperating actively with the Fund in efforts to resolve the problem of its overdue financial obligations to the Fund.

- Another remedial measure would be a declaration of censure or noncooperation which would come as an intermediate step between a declaration of ineligibility and a resolution on compulsory withdrawal. The decision as to whether to issue such a declaration would be based on assessment of the member's performance in the settlement of its arrears to the Fund and of its efforts, in consultation with the Fund, to follow appropriate policies for the settlement of its arrears. Three related tests would be germane to this decision regarding (i) the member's performance in meeting its financial obligations to the Fund; (ii) an assessment of the member's capacity and willingness to service its obligations to the Fund, reflecting exogenous factors that may have affected that capacity and payments made to other creditors; and (iii) the preparedness of the member to adopt comprehensive adjustment policies that would provide the basis for embarking on the intensified collaborative approach. The declaration would follow any communication to Governors after ineligibility and would be considered at a subsequent post-ineligibility review. The period between such communications and the declaration could be about six months, but this time period would be determined on a case-by-case basis. The declaration would be adopted by the Executive Board. No final conclusion was reached on whether the declaration should be published.

- Regarding the content of the declaration, a redraft of the draft declaration outlined on pages 2 and 3 of EBS/89/128 is attached which takes account of Directors' comments. The Board would consider proposed language in each individual case.

- On suspension of membership, Directors noted the necessity of amending the Fund's Articles of Agreement to provide for suspension of

membership. Some Directors showed an interest in introducing a provision into the Articles of Agreement under which the voting rights of a member that has been declared ineligible to use the Fund's general resources could be suspended. However, most Directors felt that it would not be advisable to propose an amendment of the Fund's Articles of Agreement at this time, but that this matter could be reconsidered in the future.

Finally the option of compulsory withdrawal remains but would only be pursued once the Fund has exhausted all other possible avenues to redress the problem of overdue financial obligations and, despite a declaration of noncooperation, the member has not exhibited a willingness to cooperate with the Fund.

Draft First Letter to Selected Governors

Dear :

With the concurrence of the Executive Board and following its review of the recent emergence of overdue financial obligations to the Fund by [member], I am writing to you in the hope that appropriate actions at this early stage would avoid the application of subsequent measures by the Fund. Prompt and effective actions now would permit these overdues to be cleared before their magnitude makes the problem more intractable and before it places a financial burden on other members.

[Paragraph on background circumstances of member leading to the emergence of arrears, the views of the member regarding its overdue obligations, and the member's intended approach for addressing the problem of its overdue obligations. This paragraph would be tailored to the specific circumstances of the member concerned.]

The Executive Board is very concerned about these developments which have serious potential implications both for the [member] and for the Fund as a whole, if the problem is not resolved early. The existence of these overdue financial obligations to the Fund precludes the Fund from extending financial assistance to the member. In addition, experience to date indicates that when a country incurs arrears to the Fund its financial relations with other creditors are also likely to deteriorate. These arrears would also have an adverse impact on the Fund as an international financial cooperative, which is the central monetary institution in the international monetary system. As you are aware, overdue obligations, if they are not settled, place a financial burden on other members: on the Fund's debtor members in the form of higher charges and the Fund's creditors in the form of reduced remuneration.

The Fund would greatly appreciate any assistance your Government and the financial agencies of your country could give in encouraging [member] to address this problem in a manner that would lead to the full and prompt settlement of its overdue obligations to the Fund.

Sincerely yours,

Michel Camdessus  
Managing Director and  
Chairman of the Executive Board

Revised Draft Second Letter to All Governors and  
Certain International Financial Institutions

Dear :

The Executive Board has reviewed the overdue financial obligations of [member] and its circumstances. In this context it has concurred that I write to you to seek your assistance in resolving the problem of [member]'s overdue financial obligations to the Fund.

As you know, [member] was declared ineligible to use the general resources of the Fund on [date], as it had failed to meet its financial obligations to the Fund and had not responded in a manner satisfactory to the Fund to earlier requests for settlement of its arrears. As of [date], [member]'s overdue financial obligations to the Fund amounted to SDR[ ] million and the longest overdue obligation had been outstanding for [ ] months. As you are aware, these overdue obligations reduce Fund resources available to help other members and place a financial burden on debtor members in the form of higher charges and on creditor members in the form of reduced remuneration.

[Paragraph on background circumstances of member leading to the emergence of arrears, the views of the member regarding its overdue obligations, and the member's intended approach for addressing the problem of its overdue obligations. This paragraph would be tailored to the specific circumstances of the member concerned.]

The Fund has developed an intensified collaborative approach to help a member such as [member] to clear its arrears to the Fund and restore its position in the international financial community. The Fund would like to request your assistance in urging [member] to take action toward the prompt settlement of its obligations and to this end to avail itself of the possibility of the intensified collaborative approach referred to above. So far, [member] has not taken advantage of this opportunity. If, in the period prior to the next review of [member]'s arrears, [member] does not take actions to demonstrate its willingness to resume active cooperation with the Fund toward the resolution of the problem of its arrears, [member] may be subject to declaration of noncooperation. This would be a most serious step that could lead to the consideration by the Executive Board of procedures leading to compulsory withdrawal of [member] from the Fund. In this connection the gravity of these arrears for the [member] and for the Fund, the cooperative monetary institution at the center of the international financial system, should be underscored. The Fund would appreciate whatever actions [Government/institution] considers appropriate including to consider informing relevant financial agencies of your country of the failure of [member] to fulfill its financial obligations to the Fund and of the adverse consequences of these overdue obligations for [member] as well as for the Fund and its other members.

[The reference to informing agencies would not be included in communications to international financial institutions.]

The Fund's Executive Board has emphasized the critical stage with respect to [member]'s arrears and has stressed its sincere hope that the consideration of further steps will be unnecessary. Your assistance in supporting the Fund's continuing efforts to resolve the problem of overdue financial obligations will be highly appreciated by the Fund and its membership. The Executive Board will review again [member]'s arrears not later than [date]. [I would be grateful if you could give me the benefit of your views on this matter.]

Sincerely yours,

Michel Camdessus  
Managing Director and  
Chairman of the Executive Board

Draft Declaration on Censure of Noncooperation

The Fund notes that, since the declaration of ineligibility on [date], the member has remained in arrears to the Fund, thus persisting in its failure to fulfill its obligations under the Articles, and that the level of its arrears has not decreased (or has increased);

notes that the member has made payments to other creditors while not discharging its obligations to the Fund (or not to the same extent), thus ignoring the preferred creditor status that members are expected to give to the Fund;

thus finds the member failing to cooperate with the Fund;

urges the member to discharge its obligations to the Fund promptly and to cooperate with the Fund;

reminds the member that arrears to the Fund, which is a cooperative institution, are detrimental to the whole membership of the Fund in that they hamper the proper performance by the Fund of its function of assisting members facing balance of payments difficulties;

informs the member that, unless its arrears to the Fund are fully settled within a reasonable period, the procedures under Section 22 of the By-Laws leading to compulsory withdrawal could be considered;

calls on all members to cooperate with the Fund toward the solution of the problems created by the member's arrears to the Fund.