INTERNATIONAL MONETARY FUND

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M. Camdessus, Chairman

Executive Directors	Alternate Executive Directors
G. K. Arora	L. E. N. Fernando
F. Cassell	C. Enoch
C. S. Clark	
Dai Q	
T. C. Dawson	
J. de Groote	
E. T. El Kogali	
E. A. Evans	
	R. J. Lombardo
	M. A. Fernández Ordóñez
	S. Appetiti, Temporary
M. Finaish	A. M. Othman
M. Fogelholm	I. H. Thorláksson
	O. Kabbaj
G. Grosche	
	T. Sirivedhin
A. Kafka	L. M. Piantini
	J.-F. Cirelli
Mawakani Samba	
Y. A. Nimatallah	M. Al-Jasser
G. A. Posthumus	G. P. J. Hogeweg
K. Yamazaki	

L. Van Houtven, Secretary and Counsellor
M. J. Miller, Assistant

Also Present

IBRD: E. R. Grilli, Economic Advisory Staff. African Department: R. C. Williams. Asian Department: E. J. Bell. Exchange and Trade Relations Department: L. A. Whittome, Counsellor and Director; J. T. Boorman, Deputy Director; T. Leddy, Deputy Director; G. R. Kincaid, M. Shadman-Valavi, B. C. Stuart. Legal Department: F. P. Gianviti, General Counsel; W. E. Holder, Deputy General Counsel; R. H. Munzberg, Deputy General Counsel, P. L. Francotte. Middle Eastern Department: J. Hicklin, M. Zavadjil. Research Department: P. Isard, S. Takagi. Treasurer's Department: G. Laske, Treasurer; D. Williams, Deputy Treasurer; J. E. Blalock, D. Gupta, B. E. Keuppens, O. Roncesvalles, G. Wittich. Western Hemisphere Department: S. T. Beza, Counsellor and Director; J. Ferrán, Deputy Director. Special Advisor to the Managing Director: A. K. Sengupta. Personal Assistant to the Managing Director: H. G. O. Simpson. Advisors to Executive Directors: N. Adachi, M. B. Chatah, K.-H. Kleine, M. J. Mojarrad, B. S. Newman, D. Powell, F. A. Quirós, A. Raza. Assistants to Executive Directors: B. A. Christiansen, E. C. Demaestri, Di W., S. K. Fayyad, M. Hepp, L. Hubloue, A. Iljas, J. M. E. Jones, K. Kpetigo, C. Y. Legg, G. Montiel, J. A. K. Munthali, D. Saha, J.-P. Schoder, J. C. Westerweel, Yang J.

1. OVERDUE FINANCIAL OBLIGATIONS - STRENGTHENED COOPERATIVE STRATEGY

The Executive Directors resumed from the previous meeting (IS/90/9, 2/7/90) their consideration of the Managing Director's statement at Informal Session 90/8 (2/7/90) on strengthening the cooperative strategy on overdue obligations, taking up Section 3 on measures of deterrence.

The Chairman stated that in his view, Directors would be attempting in the current discussion to find solid building blocks with which to construct, later on, a more ambitious edifice. The discussion would be preliminary, with final positions to be developed later, once the solidity of the ideas that would be advanced was assured.

Mr. Nimatallah said that the idea of deterrence was more appropriate than the idea of penalties or remedial measures that had been put forward earlier. It was important that the Fund not be seen to be out to penalize members in arrears or not cooperating; rather, it should be seen to be striving to solve the problem, and to ensure that once solved, it did not recur. Indeed, those participants in the debt strategy who were assisting the Fund in trying to solve the problem would be greatly disappointed if, once disposed of, it were only to come up again.

It only made sense to insert a provision on the suspension of voting and related rights of membership between a declaration of ineligibility and compulsory withdrawal, and to secure the necessary amendment of the Articles of Agreement on suspension, Mr. Nimatallah concluded. A qualified majority would surely be appropriate to impose the suspension of membership in any particular case, and like the Chairman, he believed that that majority should be 70 percent of the total voting power.

Mr. Posthumus commented that, depending on the circumstances, perhaps the deterrent measures should not be followed in the same order in every case, and some steps could perhaps be eliminated. For example, actions like those taken some time ago by Zambia and Peru might justify an almost immediate declaration of noncooperation, or even other steps, without having to be preceded first by less severe steps.

He would have difficulties in requesting other bilateral creditors to follow the practice of the Paris Club with respect to overdue obligations to the Fund, Mr. Posthumus went on. Other bilateral creditors would be largely the donor agencies. He was not optimistic that such a call from the Fund would be heeded in any case; moreover, the result might be that the aid agencies would attempt to meddle in the affairs of the Fund more than they did already, as well as in the internal affairs of the creditor countries themselves. Surely that would not be advisable.

In his view, indicating to a country in arrears that it would have available to it an extension of the period for consenting to the increase in its quota under the Ninth General Review was the very opposite of

deterrence, Mr. Posthumus remarked. He could not see that such a provision provided any deterrent, at least not as it had been formulated.

He supported the qualified majority of 70 percent of the total voting power for the decision to suspend a member's voting and related rights, Mr. Posthumus concluded.

The Chairman observed that Mr. Posthumus was probably right that the possibility of extending the period of consent for a member in arrears was not a deterrent. However, it could be seen as an incentive for the country to adopt expeditiously a Fund-monitored program under the arrangements for emerging from arrears. The text might need to be reformulated. He wished to hear the views of others on the underlying principle.

Mr. Kafka pointed out that only a country in arrears that was cooperating with the Fund would have an extension of the period for consenting to its increase in quota. The country would therefore have to take positive steps which were in the interest of the Fund and of the international community before being allowed such an extension.

Mr. Cassell said that in general he had no problems supporting the section in the Managing Director's statement on deterrent measures. While he could see Mr. Posthumus' point, he had no difficulties with the substance of what had been proposed for extending the period of consent for countries in arrears which were cooperating with the Fund. It might fall more naturally under another heading, but he agreed with the proposed procedure.

He agreed emphatically that any deterrent measure, to be effective, must be credible, Mr. Cassell concluded. Reflecting on the experience with the procedures for compulsory withdrawal, one way to achieve such credibility would be to require a 70 percent majority of the total voting power to suspend a member's voting and related rights, rather than an 85 percent majority. His authorities would support an amendment of the Articles on suspension of voting and related rights of membership.

Mr. Dawson said that the staff paper showed that there were no insurmountable obstacles to the suspension of voting and related rights of membership. He continued to believe that suspension should be linked directly to members' failure to meet their financial obligations--namely, to a declaration of ineligibility.

He was concerned that suspension following a declaration of noncooperation could lead to excessive delays, extend the process for considering remedial measures, and undermine the deterrent effect, Mr. Dawson continued. Those concerns could be ameliorated by specifying that the consideration of a declaration of noncooperation would follow the declaration of ineligibility within a specified agreed period. Perhaps suspension should come into effect upon the declaration of noncooperation, to put teeth into the declaration. There was also the question of the

relationship between suspension and the implementation of a Fund-monitored program. He wondered whether the failure to implement a program satisfactorily would be considered noncooperation, and whether suspension would come into effect following that.

He would prefer the broadest possible application of suspension, Mr. Dawson concluded, including the suspension of the voting rights of the member on amendments of the Articles of Agreement and during elections of Executive Directors, the suspension of the right of the member to appoint a Governor, which would also effectively suspend the Governor's ability to vote or attend meetings, and the suspension of the right of an Executive Director to cast the vote of a suspended member.

Mr. Grosche stated that he broadly agreed with the Managing Director's suggestions. The early application of deterrent actions, especially for countries judged to be not cooperating, seemed wholly appropriate. He would recommend that the Fund apply its established procedures not only earlier, but also in a more automatic fashion.

He continued to be skeptical about penalty charges, Mr. Grosche went on. While they did not seem to add much to deterrence, they might complicate the settling of overdues after a country had become cooperative. However, he would be willing to look into the issue again if it were thought worthwhile.

After the communication to the Governors, a public declaration of noncooperation should be proposed at the subsequent review of the member's overdue obligations, or within six months following the dispatch, whichever was earlier, Mr. Grosche stated. However, he doubted whether a sentence announcing the possibility of compulsory withdrawal should be included in the declaration if the Fund was not absolutely sure that it could follow such a course to the very end. To be sure, the ultimate measure of deterrence--compulsory withdrawal--remained available to be used, and he would be ready to use it, in one case in particular. He could however understand the reluctance among his colleagues to recommend to Governors that such a big step be taken after a declaration of noncooperation. A somewhat smaller step was not yet available, and he therefore welcomed suggestions to design one. The Fund needed to be aware, however, that an amendment to the Articles of Agreement was quite a task, and that the constitution of a country was not amended whenever it was deemed desirable to solve the problem of the day. Provided the Board proceeded carefully and deliberately, he would be willing to go along with an amendment to allow for a suspension of voting and related rights of membership. However, Directors should bear in mind that the Fund was not allowed to make mistakes in amending the Articles; a new amendment would be only the third in the Fund's long history. He had found the staff note on suspension very helpful in clarifying the issues that would need to be considered.

He was not yet in a position to express a firm view on the question of the necessary majority for the suspension of a member's voting rights, but a special majority of 70 percent of the total voting power seemed on the high side, particularly if one took into account Mr. Dawson's view that the suspension of voting rights should be seen more as the step between a declaration of ineligibility and the declaration of noncooperation, Mr. Grosche remarked. While he had seen the suspension of voting and related rights of membership as falling more between the declaration of noncooperation and the resolution on compulsory withdrawal, he had found Mr. Dawson's point quite interesting, and he was ready to think again about the sequence of steps. Perhaps the sequencing should be discussed further.

He could go along with all the other points included in the Managing Director's statement, Mr. Grosche concluded.

Mr. Nimatallah commented that it would be difficult to conceive of suspending a member's voting and related membership rights before a judgment of noncooperation had been rendered. Noncooperation was the key reason--among others--for which a member might have its rights suspended. Therefore, a declaration of noncooperation must precede a resolution on the suspension of membership rights.

Mr. El Kogali said that he agreed with Mr. Nimatallah. A declaration of noncooperation was the cornerstone, upon which sat the rest of the procedural structure. Suspension of voting and related rights of membership should only follow a declaration of noncooperation.

Mr. Dawson observed that, even in the light of the current level of overdue obligations, no members had been declared noncooperating to date. The declaration of noncooperation therefore did not appear to be a very effective weapon.

The Chairman commented that the fact that the declaration of noncooperation had not been used was not a sufficient reason to judge that the mere threat of employing it had not had some effect on the overall debt strategy. The threat alone had been effective in reducing the number of countries in arrears to the Fund, in his view.

Mr. Dawson responded that, notwithstanding the reduction in the number of countries in arrears, the magnitude of the problem had not changed. There was no doubt that the communications to Governors about members in arrears had had some effect, but only on those countries whose overdues were not large. On the worst cases, the effect had been minimal. Deterrent steps would be more effective if they came into play at an earlier stage. The current penultimate step--the declaration of noncooperation--was a rather weak step, which argued for creating another intermediate step that might be taken more seriously by members in arrears.

Mr. El Kogali remarked that there was as yet no clear consensus on the need to build bigger and bigger deterrents to arrears, with worse and worse effects on members.

Mr. Nimatallah said that the declaration of noncooperation might be brought to bear sooner in the process of dealing with arrears. He would have difficulty in voting in favor of any proposal for sequencing the steps in the way Mr. Dawson was suggesting, however. The sequence should clearly be the declaration of noncooperation, the resolution on suspension of voting and related rights of membership, and lastly, compulsory withdrawal.

The Chairman commented that a declaration of noncooperation would have to be based on an assessment that the country was both not fulfilling its financial obligations to the Fund, and was following poor economic policies. A declaration of noncooperation required only a simple majority in the Board; suspension of voting and related rights would require at least a 70 percent majority. Simply for that reason, to reverse the steps in the way Mr. Dawson had suggested would be bizarre, as the subsequent step would require, in that case, a smaller majority than the step preceding it.

Mr. Dawson said that there was too much delay involved in pursuing a declaration of noncooperation.

Mr. El Kogali observed that often the delays originated in the Board itself, and that there was no reason why, because of the Board's own slowness, the member countries should be punished.

The Chairman said that there was no question but that the Directors and the Fund had a better perception of the ramifications of the arrears at present than they had had three years previously; if the extent of the problem had been known then, some countries--such as Liberia and Sudan--might have been declared noncooperating several years ago.

Mr. El Kogali responded that the Board needed to encourage members in arrears to pursue the struggle to regain a measure of cooperation with the Fund, and not positively to discourage it. The suspension of voting and related rights of membership should be seen as the next to the last resort. The sequence of the deterrent steps was very important, especially with respect to how it affected the psychology of the authorities of the countries in arrears. Mr. Dawson's sequence would send entirely the wrong message.

The Chairman remarked that Mr. Posthumus's point concerning flexibility in leaving steps out under certain circumstances should be borne in mind in the debate.

Mr. Mawakani said that he agreed with what Mr. Nimatallah had said with respect to Mr. Dawson's suggestion for sequencing the deterrent steps.

Mr. Posthumus said that even if the Fund had compelled the four countries with the largest arrears to withdraw years ago, the level of arrears would be the same as it was at present. Mr. Dawson's argument that a hastier progression toward expulsion might ameliorate the arrears problem was not quite valid in that sense, in his view. Nevertheless, while he agreed that the declaration of noncooperation should precede suspension of voting and related rights of membership, suspension should follow the declaration of noncooperation fairly quickly.

Mr. Cirelli stated that he could go along with the thrust of the Managing Director's suggestions with respect to widening the scope and strengthening the application of deterrent measures. However, like Mr. Grosche, he was not sure that the question of applying penalty charges should be reconsidered. The matter had already been discussed some months ago, and he was skeptical that the use of a punitive measure like penalty charges would necessarily lead to the faster clearance of arrears to the Fund. He was also hesitant to consider extending the period for consent to the quota increase for countries in arrears. If such an extension were to be granted, it would have to be related in some way to the length of time for the period of consent; the longer the period of consent that was ultimately decided, the shorter should be the period allowed for any extension, in his view.

He had no difficulty in contemplating an amendment of the Articles in order to introduce the possibility of suspending voting and related rights of membership, Mr. Cirelli concluded. He agreed with the sequencing of the deterrent measures as outlined by the Managing Director as well. The sequence of steps was indeed an important matter. Placing the suspension of rights after the declaration of noncooperation seemed quite logical to him, but he saw Mr. Dawson's point, and like Mr. Grosche, he would be willing to discuss the proper sequencing further. Nevertheless, because the suspension of voting and related rights of membership was such a severe step, it would be important to design a procedure to ensure that countries were warned far in advance of the Fund's intention to consider such a step in their case. The declaration of noncooperation could serve in that role, in his view, but perhaps there were other warnings that could be thought of as well.

The Chairman said that the idea of imposing penalty charges had been advanced before, but the Board had not approved it. However, the more he had thought about such charges, the more he had seen them in the light of a preventive measure which protected the countries themselves, not so much as a punitive measure per se. The heart of the matter was to prevent countries from even starting to go into arrears, even by a few days. Once the first step down the arrears path had been taken, the Fund had found that many countries found it difficult not to take a few more; then a full-blown arrears case developed. To impose very harsh measures at the very beginning might serve as an effective deterrent, and he would accordingly ask Directors to think again about imposing penalty charges. He himself had been against them at first, but had come around to seeing their usefulness.

Mr. Nimatallah commented that he had first introduced the idea of penalty charges for newly overdue amounts because of his own experience with the high charges levied on overdue balances on credit cards, and his personal reaction to them. The high interest rate--21 percent, in some instances--had served as an effective encouragement to pay bills on time. In his view, finance ministries would think twice about entering into overdues--even for a short period of time--if they knew that they would have to pay a heavy penalty in the form of an elevated rate of charge.

Mr. Cassell remarked that although he had been against penalty charges in the past, he would be willing to reconsider them as part of a coherent and effective arrears strategy. An effective strategy, however, would be a prerequisite for the imposition of penalty charges, because otherwise they would only add to the size of the arrears. But before committing himself, he would need to see and assess the whole arrears strategy structure.

The Chairman said that he had suggested that a suspension of voting and related rights of membership only follow a declaration of noncooperation because in many instances, the suspension would affect not only the individual country, but the entire constituency in the Fund's Executive Board. Therefore, it was reasonable to expect that the other countries in the constituency would try to come to the rescue of the member in arrears. Some period of delay between the declaration of noncooperation and the suspension of rights would therefore be appropriate, in order to allow the other members of the constituency mobilized with the objective of solving the arrears at that point, before the suspension of membership would be brought to bear.

Mr. Appetiti asked whether the provision under which a member in arrears would not be allowed to subscribe to its quota increase under the Ninth General Review would be made part of the deterrent measures in general, with application to future quota increases, or whether it would apply only to the Ninth General Review. In his view, it would be appropriate, as part of the overall arrears strategy, to make that stipulation general.

The Chairman replied that, theoretically, arrears could be an issue at a future review of quotas, but the intent at present was to create a situation in which arrears would disappear, and--of course--not recur. That being said, the provision not allowing a member in arrears to subscribe to its quota increase should apply only to the Ninth General Review.

Mr. Appetiti said that he could go along with granting a member in arrears that was cooperating with the Fund an extension of the period in which to consent to its quota increase provided that the extension had a fixed time period and was not open ended. For example, if a member in arrears was in the middle of a process of clearing the arrears, and if it was undertaking a Fund-monitored program, the Executive Board should reassess the country's situation and allow an extension of the period of

consent by, perhaps, from one to three months. However, multiple extensions of the period for consent should not be allowed.

Mr. Kafka said that the deterrent measures were part of a package that also included the size of the quota increase, which the Board had yet to determine. In essence, the Fund's arrears strategy had to focus on the best ways of getting the Fund's money back, and that point should not be lost sight of in the debate.

He opposed fixed periods for the imposition of sanctions, Mr. Kafka stressed. The case-by-case approach which had served the Fund so well in other respects should be applied to the arrears problem as well. Also, it needed to be borne in mind that very often, a change in government would make it possible for a country to clear its arrears within a reasonable time. The Fund should not expose a country to the effects of sanctions for perhaps an inconvenient period, especially since in many cases members were not failing to pay the Fund not out of ill will, but because of their particular circumstances.

He fully supported Mr. Nimatallah's view that it would make no sense to have a declaration of noncooperation follow the suspension of voting and related rights of membership, Mr. Kafka went on. There was also no need to add threats to a published declaration of noncooperation, because surely the Fund's members--as well as those concerned with the Fund--knew what sanctions were at the Fund's disposal. The result would be simply to make the recovery of the Fund's money more difficult.

The Fund should not appear to be in the position of building a case against particular member countries, Mr. Kafka pointed out. He therefore opposed the idea of calling on others to suspend credit to countries in arrears to the Fund. With respect to the provision not allowing a member in arrears to subscribe to its quota increase, he would merely add that it was not only a question of the period of consent, but also of what to do with a country which cleared its arrears after the expiration of the period of consent. The Fund should be prepared to extend sympathetic consideration to such a country, in his view.

He opposed the idea of suspension, Mr. Kafka stressed. His thoughts were very like those of Mr. Grosche on the care which should be taken in attempting to amend the Articles in that regard. Unlike Mr. Grosche, however, he did not have an open mind about an amendment to authorize suspension. If the Board was to come to a conclusion on the Ninth General Review by March 31, 1990, there was not enough time left to give the question of amendment the careful consideration it deserved. That notwithstanding, if the idea of suspension were approached, he would stress that suspension in any partic-ular case should not be imposed with less than an 85 percent majority of the total voting power, because suspension was such a serious sanction that it would destroy a country's creditworthiness like nothing else the Fund had done so far. A sanction, to be useful,

should be not only effective, but also fair. It could be that some countries, or a country, could exert such pressure from time to time on smaller countries that only the protection of exceptionally large voting majorities would provide an assurance that capricious decisions would not be taken.

For the reasons others had already given, he did not think that penalty charges were a good idea, Mr. Kafka concluded. They would merely complicate matters and make it more difficult for countries to pay. They should thus be forgotten for good. Finally, the questions of gold sales and SDR allocations were necessarily part of the arrears strategy package, and would have to be considered before a conclusion was reached.

The Chairman commented that in the Fund's experience, member countries were often extraordinarily unaware of what the rules of the game were, and of exactly what measures were available to the Fund, despite the best efforts of the Executive Directors to convey such information. That being said, it would be useful to communicate with member countries from time to time when the situation required, to explain the rules of the game.

Because the Fund had not yet declared any member noncooperating, it could not be fairly said that a declaration of noncooperation would destroy a country's creditworthiness, the Chairman pointed out. It might be observed that a country which entered into arrears vis-à-vis the Fund had effectively already renounced its own creditworthiness by that action. By the time of a declaration of noncooperation, any remaining creditworthiness could be said to have disappeared. For all those reasons, he did not believe that the declaration of noncooperation itself could be opposed on the grounds that it destroyed a member's creditworthiness, although it could be opposed on other grounds, of course. Naturally, any proposal to make a declaration of noncooperation would have to be judged on a case-by-case basis.

Mr. Kafka said that he had spoken of destruction of creditworthiness more in relation to suspension of voting and related rights of membership, rather than the declaration of noncooperation. Like everything else in life, creditworthiness was a continuum.

The Chairman said that in that case, his points applied even more strongly.

Mr. Kafka replied that he was not certain that that was indeed so.

Mr. Fogelholm made the following statement:

> My authorities agree that the strengthened arrears strategy should be complemented by measures of deterrence. The assessment of what is needed in each case should be made on an ad hoc basis, the leading principle being that sanctions should indeed enhance--

and not weaken--the arrears country's incentives to clear its overdue financial obligations to the Fund. A more automatic approach, with fixed periods, could, of course, be appealing, but I believe that our experience with the application of our policy on ineligibility shows that that is not easy to achieve.

As a matter of principle, we also believe that the Fund should be cautious in introducing sanctions, the actual effects of which could be limited, thereby carrying the risk of weakening the Fund's credibility.

With regard to the question of sequencing, I find it logical that the Board first should decide on whether or not a member is cooperating with the Fund, and only then take up the matter of suspending members' voting rights. Sanctions should, in principle, be applied only to noncooperating member countries.

We would prefer that a loss of voting rights not have to be effected at all. In the final analysis, however, we are willing to approve such a measure as part of an acceptable compromise. Nevertheless, like Mr. Grosche, we cannot accept an automatic link between the suspension of a member's voting rights and compulsory withdrawal.

With regard to the Managing Director's proposals with respect to securing the recognition of the Fund's preferred creditor status, I fully share the views expressed by Mr. Posthumus that we should be cautious in applying such an approach, and that the positive results of such measures are not immediately perceptible. Having said that, I completely agree with the concerns underlying the Managing Director's proposals, and note that the incompatible behavior of donors has aggravated the situation on many occasions, and enabled countries to continue pursuing incorrect policies.

We are at this stage of two minds on the question of the participation of countries with arrears in the Ninth General Review of Quotas. On the one hand, the Fund should treat its members equally, and consequently, the period of consent should be the same for all. On the other hand, we have some sympathy for the more flexible approach toward members in arrears which are collaborating with the Fund.

Regarding the majority needed to enact a suspension of voting rights, we do not have a final position, but it would seem that the Managing Director's proposal of 70 percent would be appropriate.

The Chairman said that he understood the point of view of Mr. Fogelholm and Mr. Posthumus on the problems that might be encountered in trying to convince aid agencies to follow the Fund's approach in dealing with countries in arrears to the Fund. However, he still believed that it was essential to try to convince them of the usefulness--indeed necessity--of the Fund's policy in that regard. In the final analysis, what the Fund was doing was in their own best interest as well as the Fund's. It made no sense for the aid agencies to keep on extending credit to countries whose policies were inherently deficient. The Fund had to persevere in trying to convince the aid agencies of those points.

Mr. Fogelholm said that he agreed with the Chairman. However, the problems that might arise might be seen more clearly by examining the Fund's past attempts to convince its sister organization, the World Bank, of its policies in trying to solve arrears, and what the Fund saw as the appropriate response on the part of the Bank in those instances. The feasibility of encouraging action by the aid agencies remained very questionable, and it seemed that the perspectives of the Fund and the aid agencies were light years apart in that regard. Caution was needed, so as not to exacerbate the situation even more.

Mr. Dawson said that it was clear that it would be difficult to overestimate the difficulty of convincing the aid agencies to follow the Fund's approach. Nevertheless, if the Fund did not have preferred creditor status vis-à-vis the governments of members, it was hard to conceive of it having such status vis-à-vis the commercial banks. Mr. Posthumus was right in saying that optimism in assuming the success of the Fund's efforts in that connection might be misplaced, but the fact remained that the Fund should nevertheless persevere.

He recalled that Mr. Fogelholm had noted the difficulties in trying to prescribe a rigid timetable for the imposition of deterrent measures, calling attention in particular to the inconsistencies that had arisen in the declaration of ineligibility in past cases, Mr. Dawson went on. Although those experiences might have been somewhat problematical, they did not argue against more rigid timetables in the future, in his view. It was true that the presumption of automaticity should be avoided, but it should be clear that all of the instruments at the Fund's disposal would be available to be used, if needed. The practice seemed to have been the opposite so far, in that many of the instruments were simply not being used.

That did not militate against the case-by-case approach, Mr. Dawson pointed out. For example, he had noted that those countries which were closest to being declared noncooperating were not the oldest arrears cases, which showed that Directors were already exercising discrimination and taking into consideration the individual circumstances of members. Indeed, it was to be hoped that arrears would be cleared without having to employ any of the deterrent measures the Board was discussing.

The Fund's lack of experience with arrears cases, until the recent past, had perhaps contributed to a lack of urgency in dealing with them, and the idea that arrears would only be temporary, Mr. Dawson commented. However, some of the arrears cases were five years old. For the Fund to allow arrears cases to persist for such a period of time without coming to a final decision about how to deal with them was simply inappropriate, and would only damage the Fund in the longer term.

Mr. Posthumus said that he could not agree more with the Chairman about the foolishness of development agencies which continued to spend development assistance in countries which refused to adjust and refused to repay the Fund. However, the aid agencies of many countries had large programs, and strong political support. The Fund would need to be wary of the ramifications of challenging those constituencies. He would warn against the Fund attempting to lay down to aid agencies any formal rules. Rather, the Fund should continue to try to convince them to spend their aid money in other ways. Finally, it needed to be borne in mind that the arrears problem was ultimately the Fund's problem, and that it would be up to the Fund--and not others--to solve it.

The Chairman said that it had taken a long time to convince aid agencies that even the most well-intentioned and charismatic of rulers could do severe damage to the economies of their nations if they followed inappropriate policies.

Mr. Fernández Ordóñez commented that although it was true that a country in arrears to the Fund which paid a national aid agency or a Paris Club creditor was not respecting the Fund's preferred creditor status, it was also true that the creditor country which accepted that payment was also not respecting the Fund's preferred creditor status. Perhaps the creditor country should forward the payment to the Fund, therefore. That would surely reinforce and give weight to the Fund's preferred creditor status in the creditor, as well as the debtor, countries. It was somewhat hypocritical to place all the blame on the debtors in that regard. Although many paid lip service to the idea of the Fund's preferred creditor status, governments were evidently not strong enough to defend that status to the extent he was suggesting.

The Chairman said that member governments had a tendency to prefer arrears to accrue to the Fund rather than to their own agencies, and to the extent that they could, de facto, transfer arrears to the Fund, they would. That, after all, was only human nature.

Mr. Fogelholm pointed out that since most of the aid that was being granted at present was in the form of grants rather than loans, the real problem was not the acceptance of repayments by creditors, but their disbursement of new funds.

He agreed with Mr. Dawson that the Fund should try to change the minds of the aid agencies about the need to respect the Fund's preferred creditor status, and for the Fund and national governments to speak with one voice on arrears questions, but the magnitude of the task could be seen in examining the legislation in Mr. Dawson's own country. One of the recurrent features of U.S. legislation was the demand for repayment to the United States before new disbursements could be made.

Mr. Dawson said that Congress had given the President considerable authority in the debt forgiveness program, so Mr. Fogelholm's observation was not completely accurate. Some countries were no longer eligible for U.S. assistance for a number of reasons--the Brooke amendment, for example, disqualified certain countries which had not repaid the United States for military loans. Nevertheless, he believed that the Congress had in fact been very flexible, and had gone a long way in extending Toronto terms to some countries even in cases in which the debt was not developmental, but military.

Mr. El Kogali said that some member governments insisted upon being paid as a prerequisite for the furnishing of essential commodities, such as food. United States policy, for example, had required Sudan to make payment of $80 million before wheat could be shipped. Sudan had been unable to pay the Fund because of its need for food aid from the United States. It was not a question of the Sudanese people entertaining any malicious thoughts about the Fund in consequence, but of their very survival. In that respect, creditworthiness had long since disappeared from the debate; in the case of Sudan, it had become a matter of survival.

Mr. de Groote said that the more he heard, the more he believed that the Fund would have to introduce a gimmick along the lines of his proposal at the previous meeting (Informal Session 90/9, 2/7/90)--namely, the establishment of a special account in the country in arrears for repayments to the Fund, which would be considered sacrosanct. As Mr. Mawakani could attest, such an account was very effective if the government adhered with great energy to the account's principles, and made sure that it was not touched for other purposes. Such an account could also be introduced into stand-by arrangements, via an agreement that a percentage of all export proceeds received by the central bank would be placed into the special account. In the instance he had in mind, the account had been extraordinarily effective, as even those amounts were invested up to the day before the repayments to the Fund came due. He recalled that the authorities had had to resist strongly calls from the political authorities to use the funds for other purposes--morally deserving though they were.

Mr. Mawakani remarked that the relationship between aid agencies and the individual country was very complex. It needed to be considered whether it would really be appropriate for the Fund to require that, in the case of arrears, all aid agencies suspend their operations in a country--which would be essentially what would happen--regardless of the possible effects on the

people of the country. For example, many aid agencies supported the operations of schools and hospitals, which would otherwise have to be closed down. He agreed that, in theory, the Fund should be repaid first, but that decision was not always so clear-cut for the country itself. In the final analysis, the choice of which creditor to pay first was a matter of judgment.

The Chairman commented that he believed that Mr. de Groote's suggestion was a good one, which would make clear ex ante the sacrosanct nature of payments due the Fund. In fact, the Fund had already seen the introduction of such accounts in some countries. It needed to be said as well, he believed, that the trade-off which often confronted countries was not so much whether to pay the Fund or to pay for schools and hospitals, but rather to pay the Fund or to pay for armaments. It might be appealing to describe the choice as being between paying the Fund and starvation, or not paying and survival, but it was less convincing when the military spending of many countries was taken into account.

Mr. de Groote said that if aid agencies were warned in advance that a certain portion of their aid expenditures would flow to an account which would be intended to repay the Fund, he would be greatly surprised if they did not decide to change their policies in a way the Fund would approve.

Mr. Clark stated that he was in general agreement with the suggestions in the Managing Director's statement. The existing arrears strategy was based on peer pressure and certain penalties, and he believed that peer pressure was important and had a role to play. Countries should make every effort to convince their colleagues to correct the situation. Like Mr. Cassell, he believed that the issue was one of credibility and certainty with respect to deterrents. The current presumption in the discussion appeared to be that the existing procedures were not working adequately--he remained rather agnostic about that presumption. It was clear that the number of countries in arrears had diminished. As Mr. Dawson had pointed out, the amount of the arrears had however increased, but to some extent that could be attributed to the magic of compound growth, so that an increase would have been almost unavoidable in any case.

Because no member had yet been declared noncooperating did not mean that that particular instrument was not working effectively, Mr. Clark pointed out. In fact, it might be working so well that there was, in effect, no need to use it. If the Board decided to recommend an amendment of the Articles to allow for the possibility of the suspension of voting and related rights of membership, and never to use that suspension, it would not be necessarily correct to conclude that the amendment had not been an important element in the package to deal with countries in arrears. Nevertheless, in terms of reinforcing the Fund's credibility and the certainty that the instruments available to it would be used, he would support the Managing Director's suggestions for compressing the period within which those procedures must be implemented.

The value of deterrents diminished the longer the duration of the procedure, Mr. Clark observed. The steps that would be taken in dealing with cases of arrears would have to follow each other in a relatively short space of time. The issue then would be what was effective. On the one hand, the Fund would try to help countries in arrears correct the situation, through support groups and other procedures. In that sense, the period of time should not be so short that the process would fail. On the other hand, the Fund could not afford to have such a lengthy procedure that, in effect, the country remained in arrears for so long that the problem became intractable, and the Fund could then find no mechanism to deal with it. The rights approach appeared to be essentially a procedure to deal with countries whose arrears were so large that they could not be handled by current procedures. It was difficult to know the optimum time period within which the procedures should work, but he agreed with the Managing Director's suggestion that they should probably be compressed somewhat.

He had an open mind about whether a suspension of voting rights should come before or after a declaration of noncooperation, Mr. Clark concluded, but the time period between the events was the key issue in that connection. He agreed with the Managing Director's suggestion that a resolution on suspension of voting and related rights of membership should require a special majority of 70 percent of the total voting power, and that an amendment of the Articles should be pursued to that effect.

Mrs. Sirivedhin stated that in view of the time constraint, it would be preferable to adopt measures that would not require an amendment of the Articles. In applying deterrent measures, a workable and watertight definition of cooperation would be needed, so that there would be no danger of impropriety in deciding whether a member was or was not cooperating with the Fund. Members in arrears who were deemed to be cooperating with the Fund should be granted an extension of the period of consent to the increase in their quota under the Ninth General Review, by a certain cut-off date. If the suspension of voting rights was to be introduced, the majority needed to suspend a member should be large. Guidelines should be set so that suspension would be applied only in cases of clear-cut noncooperation for a prolonged period, which implied the sequence of suspension following a declaration of noncooperation. There should be a provision for the removal of the suspension once certain conditions were met. There should be no automaticity between the suspension and compulsory withdrawal.

If the Articles were to be amended, Directors should be given enough time to review the details and the implications of the proposals, and to consult with their authorities before the draft resolution was presented to the Board of Governors, Mrs. Sirivedhin concluded. The Interim Committee should also have the opportunity to examine the proposed amendments first, as rushing into an amendment would be imprudent.

Mr. Yamazaki stated that he was in basic agreement with the Managing Director's statement on deterrent measures. He supported the declaration of

noncooperation at the time of the review of a member's overdue obligations after the dispatch of the second set of communications to Governors, if such a review were held within six months of the dispatch of the communications. He also supported the suggested strengthening of the wording of the declaration of noncooperation.

His authorities were ready to consider the curtailment or suspension of World Bank and regional multilateral development bank lending, as well as a reduction in bilateral lending, as an indication of their support of the international financial community in that regard, Mr. Yamazaki concluded. He also supported the suggestion that the rescheduling of official credits be prohibited in the absence of a Fund arrangement or Fund-monitored program. He had no difficulty supporting the Managing Director's statement with respect to the treatment of member countries in arrears to the Fund in the context of the Ninth Quota Review, and he supported amending the Articles.

In response to a question from the Chairman, Mr. Yamazaki said that he was in favor of a special majority of 70 percent of the total voting power for approval of any resolution in individual cases on the suspension of voting and related rights of membership. He was basically in agreement with everything that the Managing Director had proposed in his statement, but would have to await the details in the final package on the arrears strategy to give his final approval. In that respect, like Mr. Kafka, he saw the need to adopt an entire package.

Mr. Arora stated that like Mr. Kafka, he had serious problems with the entire notion of deterrents, which were inconsistent with the nature of the Fund and with its global responsibilities. In listening to the discussion, he had formed the impression that the real issue was not the arrears problem, but rather, crime and punishment. Directors seemed to be talking about different varieties and categories of crime, to be dealt with by the imposition of the corresponding level and severity of punishment. Such a discussion begged the question of the cause of the circumstances which had led to the accumulation of arrears in the first place. It also ignored the possibility that some members may have fallen into arrears through no real fault of their own, or that even if the member were at fault, whether or not it was attempting, through cooperation with the Fund, to right it. That approach would not help to solve the problem, in his view.

He recalled the very important point made by Mr. Grosche that a transitory problem should not be the justification for bringing about far-reaching and unforeseeable changes in the character of the Fund, Mr. Arora continued. The Fund had a long history, and the arrears problem had existed in that history for only a comparatively short period of time. There had not been deterrents, and there had not been arrears. Members had not been perverse; they had dutifully tried to fulfill their obligations to the Fund over most of its history. Arrears had become a problem at present because of the particular conjuncture of historical, political, social, and economic

circumstances. Of course, he did not exclude the blame which should fall on certain countries and governments, but the prime explanation was the conjuncture of circumstances flowing from the process of decolonization. He nevertheless adhered to the Chairman's suggested compromise that Directors consider deterrent measures as part of the overall arrears strategy, provided that it was very clear that those who cooperated with the Fund would not be thrown into the category of those members who deserved to be punished.

The debate he had just heard made him anxious and worried in that regard, Mr. Arora stressed. Under no circumstances should a suspension of voting and related rights of membership flow automatically from a declaration of ineligibility. The declaration of ineligibility should be followed, in appropriate circumstances, by a declaration of noncooperation, and only thereafter should the question of suspension be considered at all, if necessary. Directors should take heed of Mr. Grosche's warning; in the Fund's history, there had been very few amendments to its Articles. The Board needed to think through very carefully any amendment which might, in his view, alter the very stature of the Fund as an international institution.

Even though the Chairman had changed his mind about the efficacy of penalty charges, he would submit that, in the real world with such high interest rates already, penalty charges would really compound the misery of countries in arrears, and do nothing to help solve the problem, Mr. Arora commented. He would suggest that the Board reconsider penalty charges in the future if Directors really felt strongly about them, and given that a number of Directors had said that they had an open mind about them.

Creditor countries, instead of resorting to debt forgiveness, should consider accepting payments from countries in arrears in local currencies, also as a way of confirming the Fund's preferred creditor status, Mr. Arora continued. He recalled that that had been suggested by the Minister of Finance of Belgium at one point, as had the United States on one or two occasions. The local currency payment could then be reinvested in the country, helping the country in its debt management and in maintaining a viable position.

If the suspension of voting and related rights of membership were accepted, he believed, like Mr. Kafka, that noncooperation should precede suspension, Mr. Arora concluded. Because suspension was a serious matter, and because it would be essential that the Fund be seen as acting in a balanced and judicious manner in applying such a prescription and that it had not been influenced by extraneous issues, a vote to impose a suspension in any individual case should be approved by a special majority of 85 percent of the total voting power.

The Chairman commented that one of the reasons he had changed his mind about penalty charges was because of the Fund's experience with the noncooperative spirit of certain other creditors to member countries.

Often, creditors seemed to suggest that countries not pay the Fund so that they would be paid instead. Penalty charges would provide an admittedly rather cynical and somewhat harsh encouragement to members to pay the Fund first.

Mr. Finaish made the following statement:

While judgments can differ on the costs and benefits of particular remedial measures, we continue to attach primary importance to ensuring that such measures are applied only in truly noncooperative cases. Procedures governing remedial policies should ensure that this will be the case both in terms of the criteria used to make a determination that nonpayment is clearly due to unwill-ingness to pay or cooperate, and also in terms of the majorities required to apply particular punitive actions.

In our past discussions, many Directors expressed doubts about the usefulness of penalty charges. These doubts, which we share, were motivated not by considerations of fairness or equity, but by the concern that penalty charges are unlikely to influence the attitude of a noncooperating member and may, in fact, make it harder to eventually clear the arrears. A convincing case to the contrary is yet to be made. But we are willing to revisit the issue if other Directors feel this would be useful.

We have no difficulty with streamlining the timetable for our procedures as suggested in the Managing Director's statement. However, we would caution against making the initiation of compulsory withdrawal procedures an almost automatic step if the member does not respond positively to a declaration of noncooperation.

We share the view that the effectiveness of remedial measures would be significantly diluted if other creditors were to ignore the arrears to the Fund in their relations with the member concerned. However, we see a risk in explicitly requesting other creditors and donors to withhold their assistance from the member or to refuse to accept payments, as suggested in the statement. In our view, the implications of such a request have not yet been fully considered, and I found the views of Mr. Posthumus and Mr. Fogelholm relevant and helpful in this area.

Regarding the quota increase for members, we continue to believe that enough flexibility should be incorporated in a quota resolution to ensure that cooperating members are not penalized. The relatively long timetable envisaged under the rights approach underscores the need for such flexibility.

The paper prepared by the staff on the suspension of voting rights raised many legal and procedural questions which need to be carefully looked at both by ourselves and by our authorities. I am afraid we are not yet in a position to give a clear view on this matter, and I share Mr. Grosche's emphasis on the need to proceed cautiously on such an important matter as the amendment of the Articles. If there is any agreement on this question, I also agree that the sequence is important, and noncooperation has to take place first. There is also another relevant and important point touched upon by Mr. Kafka--the question of voting power if there were an agreement. Of course, one sees the logic that, if we require an 85 percent majority in the case of compulsory withdrawal--which is a tougher measure--maybe the majority required for suspension should be lower. But there is also the fear expressed by Mr. Kafka and referred to in one of the informal briefings. We should think more carefully about the voting power issue if there is an agreement on the matter of suspension.

Mr. Dai said that he could agree with the idea that the intensified collaborative approach to the resolution of arrears to the Fund should be complemented by measures of deterrence, but he was skeptical about introducing new deterrent measures at the present stage. A number of new deterrent measures had already been introduced in the previous few months. Those measures had not yet been fully utilized, and it could not be said that they were insufficient or not strong enough. In practice, there was no convincing evidence that the major obstacle to solving the present arrears problem was the lack of punitive measures or the lax implementation of existing punitive measures. He therefore did not believe that introducing new measures at present was necessary.

The idea of punishment should not be overemphasized, Mr. Dai stressed. Punitive measures could be effective only when the members in arrears had the capacity to repay, but were unwilling to do so; when those members were in a position to implement strong programs, but did not; and when members had not completely lost their interest in the Fund and remained concerned with their membership status.

The present arrears problem was a unique, specific phenomenon at a specific time in the Fund's history, Mr. Dai concluded, and specific ad hoc measures were needed to deal with it. He had strong reservations about the proposal to amend the Articles of Agreement so as to strengthen some punitive provisions only because of the very specific and unusual cases of a very few members in arrears. He therefore shared the view expressed by previous speakers that the Fund must be very cautious in amending the Articles.

Mr. Lombardo stated that he agreed completely with what Mr. Kafka had said in his statement. The present was not the time to reconsider penalty

charges. Such charges would complicate the problems of countries in arrears to the Fund, and would imply the need for additional resources, at some time in the future, in order to clear arrears. The key was to find a way to get the Fund's money back; penalty charges would not achieve that.

The proposal to consider the suspension of voting and related rights of membership was an extremely serious matter, Mr. Lombardo concluded, which he could not support. That notwithstanding, if there were a consensus in favor of that proposal, a decision to suspend the rights of a member in any individual case should require a special majority of 85 percent of the total voting power. Like Mr. Nimatallah, because he saw a suspension of voting and related rights as a more severe step than a declaration of noncooperation, he believed that the former should follow the latter in terms of sequencing.

Mr. Evans stated that he could support the broad thrust of the measures the Managing Director had proposed, and he believed that he would have sufficient flexibility on most questions to go along with the consensus.

He recalled that Mr. Arora had said that a discussion of deterrents was inconsistent with the nature of the Fund, Mr. Evans observed. That was a reasonable comment; however, arrears were also inconsistent with the nature of the Fund, and the deterrents were a means to deal with them, in his view.

He could support amending the Articles in order to provide for the possibility of suspension of voting and related rights of membership, Mr. Evans went on. If such a measure was to work properly, on a case-by-case basis, then the special majority which should be required to approve it should be no higher than 70 percent of the total voting power, as the Managing Director had suggested in his statement.

He could not conceive of the Board ever agreeing to suspend a member that was cooperating with the Fund, Mr. Evans remarked. Therefore, the question of cooperation would always have to be addressed before a question of suspension; thus, the sequencing the Managing Director had proposed appeared to him to be appropriate.

He also had an open mind about penalty charges, Mr. Evans related, but he continued to lean against them, for the reasons that had been mentioned by others. All of the proposed deterrent measures would have an indirect monetary impact on the member in any case.

He believed that Mr. de Groote's suggestion that a special account be established in countries with arrears to the Fund designed for the express purpose of effecting repayments to the Fund--what he saw as essentially a sinking fund--was not merely a gimmick, but actually a serious idea well worth considering, Mr. Evans concluded. The idea amounted to a rescheduling of repurchases, in his view, because it would effectively--if not formally--bring the repurchases forward, at least from the debtor's point of view.

Mr. Kabbaj stated that he had been made somewhat uneasy by what he had heard in the discussion, for the reasons some of his colleagues had already mentioned. As the Chairman had pointed out, the problem of arrears had stabilized with the declining number of countries in arrears, despite the fact that the absolute amount of the arrears had grown. Clearly, a hard core of countries which accounted for the bulk of those arrears at present, but those countries would not be moved by the measures that were being proposed, in his view. The intensified cooperative approach to the resolution of the arrears problem had not been given enough time to work, and that was why it had not yet produced the desired results. Some of the measures being proposed ran counter to the cooperative nature of the Fund, and would lead members to adopt a confrontational perspective which was not in keeping with the historical relationship between the Fund and its members. That would indeed be unfortunate. As Mr. Kafka had pointed out, governments changed, and policies with them, so it was essential that the Fund not adopt a stance which it could not later reverse.

Like Mr. Kafka and Mr. Finaish, he believed that, if the Board decided to approve the proposed measures, it should make sure that they would be applied only to members which were clearly not cooperating with the Fund, and not to those members that, although cooperating with it, were being overwhelmed by other problems which prohibited them from solving their arrears, Mr. Kabbaj continued. Such a distinction would doubtless not be easy to draw, but given the gravity of the suggested measures, it would be essential. As Mr. Kafka had said, the Fund should retain the case-by-case approach in attempting to eliminate arrears, and the Board should have flexibility in using the measures, which should not be employed in an automatic or mechanical fashion.

He agreed with Mr. Nimatallah that the appropriate sequencing of the deterrent measures should be that which the Managing Director had suggested in his statement, Mr. Kabbaj noted.

Attempting to convince national aid agencies to support the Fund's efforts to resolve arrears by curtailing their own lending programs to countries in arrears was fraught with difficult problems of implementation, as Mr. Fogelholm and Mr. Posthumus had already pointed out, Mr. Kabbaj stressed. Also, he agreed with Mr. El Kogali that sometimes the choices for the debtor country in that connection were not real choices, but were imposed by externalities. That fact needed to be taken into account as well.

He could go along with Mr. Kafka's suggestion that sympathetic consideration should be given to those countries which eliminated their arrears after the period which had been established for the consent to the increase in quota under the Ninth General Review, Mr. Kabbaj stated.

His experience on the Fund's Board had been that Directors were almost uniformly discouraged from suggesting ad hoc amendments to the Fund's

Articles, Mr. Kabbaj observed. He therefore shared Mr. Grosche's caution on that score; the present instance was no different from others in that respect. While the first two amendments of the Articles had been far-reaching, it was clear that the one that was being proposed had been designed merely to address a problem of the hour, and that would set a dangerous precedent indeed. That notwithstanding, if there were a consensus in favor of adopting such an amendment, a special majority of 85 percent of the total voting power should be required to suspend any individual member. In that connection, he supported Mrs. Sirivedhin's point that it would be essential to set up clear guidelines to define not only what actions would trigger such a suspension, but what actions would lift it, after the country had cleared its arrears, for example.

The Chairman remarked that he agreed that changes in the Articles should only be effected with caution, and with good reason. He could not agree that deterrent measures ran counter to the Fund's cooperative character; as Mr. Evans had put it, the arrears themselves ran counter to the Fund's cooperative character. The deterrent measures were intended to right that situation.

Mr. Kabbaj commented that although, as Mr. Nimatallah had said, the deterrent measures were intended mainly for the future--to prevent the emergence of new arrears cases--they also applied to the past, because the measures were being linked to the increase in quotas, which it was clear would not be approved until the present arrears were cleared. The remedial measures that were already in place had not been helpful in solving the cases of arrears that had emerged over the previous years, and the level of arrears continued to mount. The efficacy of the remedial measures on the whole might therefore be questioned. Perhaps the lack of remedial measures was not the reason for the existence of arrears, which might be due rather to other mistakes somewhere in the system, or to the Fund's overextension in some member countries. Because the Fund was already being more cautious in that respect, it was likely that the future arrears problem would be contained to the 11 so-called "hard-core" cases that existed at present.

Mr. Grosche commented that, with respect to deterrent measures, the Fund was drawing on its past experience in order to ensure that arrears would not arise in the future. Past cases of arrears provided the Fund with lessons that could be applied in the future. He believed that at the time of the first arrears cases, the instruments available to the Fund to deal with them had not been very complete or fully developed. The current discussion of deterrent measures reflected the fact that the Fund was trying to enlarge its arsenal of weapons in that respect.

He had not meant to imply, in suggesting that an amendment of the Articles should be approached with caution and was a hard task, that he was necessarily against such an amendment, Mr. Grosche went on. The fact that the Board was considering an amendment because of the arrears problem

demonstrated the seriousness with which it viewed that problem, and the necessity of preventing future cases, in his view.

Mr. Dawson said that he appreciated Mr. Grosche's clarification of what he had said earlier. Indeed, the U.S. chair did not consider amending the Articles as its first choice, for the reasons Mr. Grosche had mentioned. However, the problem was not simply a lack of appropriate instruments for dealing with arrears. It was the disuse of those intruments that were already available--the declaration of noncooperation, for example.

Since the arrears presently constituted over 10 percent of outstanding Fund credit, and about one third of total obligations falling due to the Fund in the previous 12 months, they could not be seen as merely a historical problem, Mr. Dawson commented.

The Chairman said that as the declaration of noncooperation had only been available for application since August 14, 1989, there had not been much opportunity for the Board to employ it.

Mr. Kabbaj said that he wished to stress the concern of his constituency about arrears. Four of the countries in his constituency were contributing significantly to burden sharing in spite of their own problems, so it could not but be a major concern.

Mr. de Groote said that although he had been initially skeptical about penalty charges because they would aggravate the problem of debtors, he had taken Mr. Cassell's point that their usefulness really depended on the implementation of a coherent arrears strategy as a whole. If a more systematic and workable strategy could be designed, the arrears would probably be reduced in any case, and then the imposition of penalty charges to discourage new arrears would make a lot of sense. A rapid increase in charges in the first stages of arrears would serve as an effective warning signal to the authorities.

He recalled that Mr. Cirelli had stressed that sufficient warning should be given to the member before the imposition of the next step in the strategy, Mr. de Groote went on. A communication making clear the Fund's next move to the authorities would be called for at each step, in order to allow the member to correct the situation. The moment for considering the sanction should be automatic; the imposition of the sanction itself should not be. Rather, the Board should allow itself room for judgment before imposing the sanction, and the degree of exercise of judgment should be wider at each stage of the process. If the Board did not fix beforehand a timetable for considering the sanctions, there was a great danger that the whole system of deterrence would lose credibility.

Concerns about the sequence of the deterrent steps probably stemmed from a preoccupation of some Directors that the addition of a new step would only lengthen the period of arrears, Mr. de Groote observed. Indeed, it

would be paradoxical if the addition of a new step served to exacerbate, rather than ameliorate, the period of arrears, and he hoped that Directors' concerns in that connection could be assuaged. With respect to the actual order of steps, he had noted the Chairman's argument that the majority needed to approve each step was indicative of the proper sequence, and in that light it would be more logical to place the suspension after a declaration of noncooperation. However, another argument--and one to which he subscribed--was that the declaration of noncooperation was not a milder form of sanction than suspension, but rather the announcement, or warning, of a coming sanction.

He had not been in favor of the possibility of suspending a member's voting and related rights at first because he feared that the effectiveness of compulsory withdrawal as an instrument would be depreciated, Mr. de Groote pointed out. Indeed, the Fund's ability to use compulsory withdrawal as an instrument in its arrears strategy should remain unchallenged. However, suspension might make a lot of sense, and he would not exaggerate the importance of a decision to amend the Articles accordingly, because the scope would be quite limited. It would also prove that an amendment of the Articles was not a taboo, if there were a good reason for it. He therefore hoped that the Legal Department would start work on the text. Since the Board would not have to wait for the legislation on the amendment before considering the legislation on quotas, he did not see that an amendment would necessarily delay matters. Finally, because it would be essential for a suspension to be seen as a credible instrument to be an effective deterrent, it should require for approval in any individual case a special majority of only 70 percent of the total voting power.

He had been much interested in Mr. Evans's comments about his suggestion for the establishment of special reserve accounts in countries with Fund arrears for the purpose of repaying the Fund, Mr. de Groote continued. Perhaps the Fund might require the establishment of such an account under Fund-monitored programs, or, even earlier, under shadow programs.

The problem of perception was a key one with respect to the issue of the Fund's preferred creditor status, Mr. de Groote pointed out. Unless creditors began to react, there was the danger that countries with Fund arrears would see their arrears as only an obscure accounting problem vis-à-vis the Fund, and not part of their real-world concerns. If other creditors reacted as well, such countries might be made more aware of their responsibilities in that regard.

The arrears problem had its origin in the debt problem, and therefore should be seen as part of the overall debt strategy, Mr. de Groote concluded. The whole purpose of that strategy, as he saw it, was to help countries to restore rapidly the conditions for economic growth, which was also precisely what lay behind the Managing Director's proposed rights approach.

Mr. El Kogali said that he wished to point out that some encouraging cases had emerged in the Fund's strategy to eliminate arrears--in his own constituency, he could point to Sierra Leone and Zambia. There was even talk of forming a support group for Zambia. Countries in arrears were not in that situation of their own choosing; they had all too often been placed there by man-made or natural factors. Many of them were very poor as well, and were truly suffering. He supported Mr. Kafka's view that there should be no fixed timetable for the imposition of sanctions. The sequence of measures should be logical and natural, and absent of threats, which would be counterproductive. He was against calling on other creditors to suspend their lending to countries in arrears to the Fund.

Mr. El Kogali then made the following statement:

During the Board's meetings last week--particularly on Wednesday, when financing options were considered--I was greatly encouraged by the Board's forthright approach. Directors seriously addressed the core of the problem of protracted arrears to the Fund, and, as I had indicated earlier, we are prepared to consider strengthening all aspects of the arrears strategy. What the Board did last Wednesday was a major step in the right direction. Today, we are ready to examine additional remedial measures.

We do not believe that additional remedial measures should take the form of reinforcing punitive measures. Punitive measures do not deter a member from incurring arrears, when all usable resources have dried up. Most of these countries are very poor and have no choice, and have no control over some of the factors which led to their present predicament. Remedial measures should focus on rehabilitating the economies of these countries, and not stiffling them.

The tightening of procedures should not lead to an undue shortening of the grace period allowed for a member to respond before it is declared noncooperating. It is important to provide adequate time for the member to respond before deciding on a public declaration of noncooperation. Moreover, we should also allow Governors adequate time to express their views, or use bilateral contacts to encourage the member to give attention to the problem of arrears to the Fund. Given the alternatives, a six-month period would appear to provide adequate time for such a response.

I do not find it neccessary to ask for tangible mutual support from the international financial community. We should avoid setting precedents of asking or expecting other organizations to act on our behalf, especially since we may be

asked to return the favor in the future for other organizations, and which we would not be able to fulfill.

Countries which are cooperating with the Fund should be allowed to consent to their quota increase once the arrears have been cleared. Although the staff has suggested the end of 1991 as a reasonable deadline, I believe that the deadline for a member in arrears should be explicitly related to the implementation of a Fund-monitored program. Once such program is in place, a clear timetable for clearance of arrears would be incorporated, thus setting in train the process for consenting to the quota increase. To avoid an open-ended situation, however, a cut-off date could be the beginning of the Tenth Review, as proposed by the staff. In this case, we do not necessarily need to specify the end of 1991 as the deadline, since we would need to treat each member on a case-by-case basis.

We do not support the proposal on the suspension of voting rights. However, if suspension becomes necessary, we would insist that it should be effected only with the support of 85 percent of the total voting power in the Fund. Moreover, we would need to state clearly the objective criteria of noncooperation.

We do not support the application of penalty charges, which could aggravate the already serious problem of protracted arrears. Penalty charges fail to recognize that the problem of arrears in these countries is not a simple, temporary liquidity crunch. The Fund is a cooperative institution, and should be seen as such. Thus, we should avoid techniques that are normally applied only in commercial banking.

The declaration of an intention to initiate compulsory withdrawal following the suspension of voting rights should be clear. Perhaps the staff could elaborate on this aspect.

Mr. Mawakani commented that because the increase in quotas was seen as being in the same package as the procedures for dealing with arrears, haste in considering the arrears measures had been neccessary. He wished to associate himself with the comments of Mr. Finaish and Mr. Kafka on all the issues that had been raised in the Managing Director's statement.

Mr. Fernández Ordóñez said that he could support almost all of what the Managing Director had suggested in his statement. He wished to thank the Legal Department for the informative note it had prepared on the question of suspension of voting and related rights of membership. However, he had to report great reluctance among the members of his constituency to support an amendment to the Articles to provide for the possibility of such a suspension, for the reasons that Mr. Grosche had mentioned. On the question of

delay, he would point out that in his own country, while a decision to approve the increase in quotas could be taken by the parliament, a decision to amend the Articles, which were an international treaty, would require approval via an entirely different set of procedures, which might indeed contribute to some delay. On penalty charges, while he had been against them initially as well, he would be willing to reflect on the matter in the light of the points that had been raised by his colleagues in the discussion.

The Treasurer said that of the 32 cases in which complaints about nonfulfillment of financial obligations to the Fund had been issued by the Managing Director, only 10 had resulted in eventual declarations of ineligibility to use the Fund's resources. The other 22 members had settled their overdue obligations before the Board decided on a declaration of ineligibility. The Managing Director had not had to issue any new complaints since April 1989, and in fact, since then all new cases of overdue obligations had been cleared not later than about two months from their emergence.

The Fund's current special charges were not a penalty charge, the Treasurer pointed out, but a cost-recovery item that was applied to a member in arrears longer than ten days, and that was calculated from the day the arrears first emerged. Payment of the special charge was only required if the member failed to settle the overdue obligations within ten business days. If penalty charges were decided, they would act as a penalty only if they were to be imposed immediately following the emergence of an overdue obligation, and be made payable whether or not a member cleared its arrears within the ten-day period.

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

LEO VAN HOUTVEN
Secretary