INTERNATIONAL MONETARY FUND

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3:30 p.m., February 12, 1990

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	
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, J. Pujol, M. Shadman-Valavi, B. C. Stuart. External Relations Department: E. Ray. 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. Research Department: P. Isard. 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. Office of the Managing Director: E. A. Milne. Personal Assistant to the Managing Director: H. G. O. Simpson. Assistants to Executive Directors: T. S. Allouba, B. A. Christiansen, S. K. Fayyad, S. Gurumurthi, M. Hepp, L. Hubloue, A. Iljas, J. E. Jones, C. Y. Legg, G. Montiel, J. A. K. Munthali, D. Saha, J.-P. Schoder, J. C. Westerweel, Yang J. Advisors to Executive Directors: N. Adachi, M. B. Chatah, J. M. Jones, K.-H. Kleine, M. J. Mojarrad, B. S. Newman, D. Powell, F. A. Quirós, A. Raza.

1. OVERDUE FINANCIAL OBLIGATIONS TO THE FUND

The Executive Directors continued from the previous meeting (Informal Session 90/10, 2/12/90) their consideration of overdue financial obligations to the Fund. They had before them a staff paper on cumulative contributions under the burden-sharing mechanism (EBS/90/20, 2/9/90) and the accumulation of "rights" to access to Fund resources under Fund-monitored programs by members with overdue financial obligations (EBS/90/22, 2/9/90), together with a legal note on the suspension of voting and related rights of membership (2/1/90).1/

Mr. Kafka commented that he thought the note by the Legal Department on suspension of voting and related rights was perfect as far as it went, and he had no further remarks to make about it at that time.

Mr. de Groote requested that the staff make available a legal text of a proposed amendment to the Articles of Agreement to incorporate a provision on the suspension of membership.

The Chairman said that he had expected to have more precise suggestions from Directors on the proposed amendment before drafting a final text of an amendment. The legal note had raised a number of key policy issues which Directors might wish to address.

Mr. Dawson commented that the legal note had presented well the advantages and disadvantages of the various approaches, but had not come to any firm conclusions. The staff would need further guidance from the Board, accordingly. He had been pleased to see that the legal note demonstrated that the obstacles to introducing a provision on the suspension of voting and related rights of membership were not insurmountable. In his view, suspension should be linked directly to a member's lack of fulfillment of its obligations to the Fund--that is, directly to a declaration of ineligibility. Placing the suspension only after a declaration of noncooperation could lead to excessive delays, extend the period in which remedial measures were considered, and undermine the deterrent measures as a whole. Those concerns could be ameliorated if it were specified that consideration of a declaration of noncooperation would follow a declaration of ineligibility within a specified period of time. Indeed, perhaps the suspension could come into force at the same time as the declaration of noncooperation, which would surely add substance to the latter.

The question arose as to the relationship between suspension and the implementation of a Fund-monitored program, Mr. Dawson pointed out. For example, would failure to implement satisfactorily a Fund-monitored program be considered grounds for a declaration of noncooperation, and if so, would a suspension then also come into effect? Also, he wondered how a member

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1/ Reproduced in Annex.

would be treated who had set a Fund-monitored program in place which had subsequently gone off track.

His chair preferred the broadest possible application of suspension of voting and related rights, Mr. Dawson concluded. In particular, suspension should rescind a member's right to vote on amendments to the Articles, to participate in the election of an Executive Director, and to appoint a Governor. Furthermore, an Executive Director with a suspended member in his constituency should be unable to cast the votes of the suspended member.

Mr. Kafka asked how it would be possible to have a suspension come into effect simultaneously with a declaration of noncooperation when the decision on noncooperation was in the jurisdiction of the Executive Directors while a decision on suspension would be in the jurisdiction of the Board of Governors.

Mr. Dawson explained that decisions could be rendered simultaneously by both bodies.

The Chairman commented that Directors would indeed have to address the question of which body--the Executive Directors or the Board of Governors--would have the power to declare a suspension of voting and related rights of membership.

Mr. Kafka said that he would appreciate the Legal Department's point of view on that point. He would also oppose any relationship between suspension and a declaration of ineligibility.

Mr. Grosche commented that he believed that the Governors would have to make a decision on suspension, because the voting right of the Governor for the country which was to be suspended would be affected. It would be difficult to conceive of the Executive Board being able to approve something which deprived the Board of Governors--the highest organ--of certain rights.

The Deputy General Counsel said that Mr. Grosche's point had not been dealt with in very much detail in the legal note on suspension, and that Directors might want to keep it in mind. However, if the amendment to the Articles of Agreement on suspension--which of course would need to be approved by the Board of Governors--vested that power in the Executive Board, then the Board would have the right to exercise suspension even though it impinged on the rights of Governors. Directors might wish to examine those questions before deciding the terms of an amendment on suspension.

Mr. Nimatallah commented that because suspension would not be like expulsion--which tended to be irrevocable--it should remain in the jurisdiction of the Executive Board. Moreover, the Executive Board could act more quickly than the Board of Governors on individual suspension decisions. Once the member settled its arrears to the Fund, the Board could also design

easily and quickly procedures to reinstate the member's suspended rights. To require the Board of Governors to deal with all of those procedures would take too much time, in his view.

Mr. de Groote said that the suspension should be described in the amendment, but that the actual modalities for implementation should be left to be elaborated in the Rules and Regulations, as had been the practice in other cases. That would make the Board of Governors' consideration of the amendment a much simpler task.

The Chairman noted that the question of the jurisdictional body which should have the power to suspend remained unanswered. He understood that because a decision on suspension could be seen as temporary, it could be in the Executive Board's jurisdiction, but since suspension would also affect the rights of Governors, the argument could be made that it lay in the Board of Governors' jurisdiction. He did not believe that Mr. Grosche's point had yet been adequately addressed in that connection.

Mr. Kafka said he would object strongly to allowing the Executive Board to suspend the voting rights of a Governor. The hierarchical relationship argued against an inferior being able to deprive the superior of his rights.

The Deputy General Counsel, responding to a question from Mr. Grosche, stated that there was an important distinction between rights of membership in general, and more specific membership rights. In the legal note, the staff had concluded that it would be more appropriate to address the narrower rights of membership--limited to voting and related rights. To attempt to suspend more general rights of membership would lead to considerable difficulties in terms of accommodating the balance of rights and obligations that was specified in the Articles of Agreement.

A member's breach of an obligation in the General Department would be one of the grounds for initiation of suspension procedures, the Deputy General Counsel continued. Because the Articles had drawn a very clear distinction between the General Department and the Special Drawing Rights Department, however, the nonfulfillment of an obligation in the General Department would have no carry-over effects on the member's status in the Special Drawing Rights Department. The staff believed that the distinction should be maintained.

Mr. Arora stated that the legal note presented very clearly the complexities involved in providing for suspension of voting and representational rights. The idea was not as simple as it had looked at first. Whereas a declaration of ineligibility affected only one member, suspension of the voting and related rights of one member in constituencies with more than one member would affect the other members of the constituency as well, and in diverse ways.

It was logical that suspension should follow a declaration of noncooperation, Mr. Arora stressed, and not be made simultaneously with the declaration of noncooperation. A member declared to be noncooperating should be afforded some time to reverse that situation. To make suspension simultaneous would deprive a member of that grace period, and the intent of having a progressively more severe set of steps would be lost.

A declaration of ineligibility affected a member's financial situation, but a resolution on suspension would affect the member's political standing in the international community, Mr. Arora pointed out. Because of that severe effect, specific criteria defining exactly what constituted noncooperation should be laid down.

Since a decision on suspension would affect the political rights of the member through the member's Governor, he believed that it would be appropriate, even if it were not strictly required, to vest such a decision in the Board of Governors, Mr. Arora concluded.

Mr. Nimatallah remarked that leaving the decision on suspension in the hands of the Board of Governors would be a less effective procedure than putting it into the hands of the Executive Board. In his view, suspension would be similar to ineligibility, because it would be the member, and not the Governor, who would be suspended.

Mr. Grosche said that he remained uncertain about which body should more appropriately approve a decision on suspension. The argument could be made that by requiring a decision on suspension to be made at the governmental level--the Board of Governors--the attention of the whole membership would be focussed on it, and the procedure itself would thus act as a significant deterrent. He therefore did not believe that the idea of vesting the decision on suspension in the Board of Governors should be abandoned, although he was willing to listen to the views of others on that point.

Mr. Nimatallah said that there was no need to be hasty to open a case to international debate. Compulsory withdrawal decisions would still rest with the Board of Governors, after all. He believed that the intermediate step which a suspension represented should still remain in the hands of the Executive Board.

Mr. Kafka said that he believed strongly that there should be no suspension of voting and related rights of membership, but if there were to be such a provision, the decision should be vested in the Board of Governors. It was incorrect to conclude that that would delay matters, because the Board of Governors could vote without meeting at any time.

The Deputy General Counsel, responding to a question from Mr. Fogelholm, said that no generalizations could be made as to why certain decisions required a special majority of 85 percent of the total voting power, whereas others required 70 percent. In general, the nature of the decision

determined the majority that was required for approval, and it was not related to the organ which took the decision.

Mr. Dawson recalled that an 85 percent majority of the total voting power in the Executive Board would be required for a decision to sell the Fund's gold.

Mr. Grosche said that it was his understanding that a resolution on the amendment of the Articles would need to be presented to parliament in the Federal Republic of Germany before his authorities would be enabled to vote on it. A matter to be presented to parliament needed to be prepared on the interagency governmental level. He could not therefore take any decision on an amendment at the present juncture, even if it involved only a few words in the Articles, with the method of implementation being left to the Rules and Regulations later on. He wondered whether the staff had any idea how extensive an amendment of the Articles might be.

The Deputy General Counsel responded that the extent of the amendment would depend on the scope of the suspension to be introduced. If suspension only affected voting and representational rights of members, another section could be added to Article XXVI on ineligibility and compulsory withdrawal. Other consequences of such an amendment could be dealt with through amendments of the By-Laws and Rules and Regulations.

Mr. Finaish commented that an issue the Board would need to bear in mind would be a member's willingness to fulfill its other obligations if its representational and voting rights were suspended--such as to consult with the Fund under Article IV, for example. In such a case, how would the member be represented? He recognized that that was probably not a legal issue, but it needed to be considered in assessing the likely effectiveness of the suspension measures.

The Deputy General Counsel replied that all of the obligations of the suspended member would continue.

Mr. Posthumus asked whether there was a Rule or Regulation that specified which body in the Fund had the power to present draft amendments of the Articles to the Board of Governors. It would be odd if, despite the Executive Board's power to propose such amendments, Executive Directors were required to ask their Governors what to do first.

The Deputy General Counsel replied that Article XXVIII provided that the proposed modification of the Articles could emanate from a member, a Governor, or the Executive Board. In the past, proposals for amendment had originated in the Executive Board.

Mr. Grosche said he was not clear how to proceed. He wondered whether the staff needed further guidance from the Board on how to formulate a resolution on the draft amendment. Perhaps there were issues that could be

clarified first that would speed the whole amendment process--for example, the percentage of the total voting power that would be required to approve a member's suspension. He would not want to recommend to his Governor a vote in favor of a resolution unless he was certain that his Governor had had ample opportunity to discuss the matter with his colleagues in the government first--particularly the Minister of Justice. On a related point, he would hope that the resolution could be drafted in such a way as to attract as much support for it as possible in national capitals, and in that respect, that there would be some room for maneuver.

The Deputy General Counsel responded that a Governor might arrange to vote in favor of an amendment before having secured all the necessary steps within his government for the implementation. Until the number of members prescribed by Article XXVI-II had accepted the amendment, the amendment would, of course, not be in effect. Only after the necessary majority of members had communicated their acceptance in favor--three fifths of the members having 85 percent of the total voting power--would the amendment become effective.

Mr. Nimatallah asked the General Counsel to describe what the Executive Board's options were with regard to drafting a resolution on the suspension of voting and related rights of membership.

The General Counsel responded that the conclusion of the Board's past discussions on suspension was that it would be advisable to suspend only certain of a member's rights, such as voting rights. The Executive Board already had the power to suspend certain rights, such as the right to use the Fund's resources, which stemmed from a declaration of ineligibility.

A second issue was whether it would be preferable to suspend only the voting rights of the member itself, or also the voting rights of the Governor, or Executive Director appointed or elected by the member, the General Counsel went on. It seemed logical that if a member's voting rights were suspended, the voting rights of the Executive Director or Governor (it had appointed or elected) should also be similarly affected. Such provisions could be contained in a fairly simple amendment of the Articles, with consequential changes to be taken care of in the By-Laws, Rules and Regulations.

A third issue the Board would have to examine was the determination of the organ in the Fund that should have the power to suspend members' voting and related rights, the General Counsel continued. Since the Executive Board already had the power to suspend certain rights--such as the right to use the Fund's resources--by analogy there was no reason why the Board could not also have the power to suspend a member's voting rights. However, it could also be argued that because a declaration of ineligibility was intended to be interpreted as the Fund's first reaction to arrears, with suspension as the second and more severe reaction, then the decision on suspension could likewise be seen to lie with a higher body than the

Executive Board--the Board of Governors. The majority required to approve a resolution of suspension could likewise be higher than for a declaration of ineligibility, along the same line of reasoning. However, there was no absolute relationship between the majority required and the organ; a special majority might be required in the Executive Board, and a simple majority in the Board of Governors, for example. The Board would eventually have to decide those questions.

The Chairman commented that the discussion had revealed that the time was at hand for the staff to begin drafting a proposed resolution and amendment on the suspension of voting and related rights of membership, reflecting the options the Board would have. He suggested that Directors turn to the paper on the accumulation of "rights" to access to Fund resources under Fund-monitored programs by members with overdue financial obligations (EBS/90/22, 2/9/90).

The Director of the Exchange and Trade Relations Department and Counsellor observed that in the paper, the staff had attempted to avoid any inferences about the sources of finance for the rights approach. The quantitative information in the paper needed to be interpreted with that in mind.

Mr. Kafka commented that the rights approach was an imaginative idea which served not only to solve a practical problem--arrears to the Fund--but to create an incentive for countries to avoid any delinquencies in payments to the Fund. However, he perceived two problems with the approach in connection with timing.

First, Mr. Kafka went on, unless a period of several years were to transpire before the rights were disbursed, the total amount of Fund credit outstanding for countries involved in the rights approach would be an extremely high percentage of their quotas. Consequently, such countries would be allowed access to an extent that the Fund would not have allowed ordinarily. For example, the staff paper noted that of the five largest overdue cases, an annual accumulation of rights of between 67 percent and 167 percent of quota would be implied. It was odd that the Fund would consider allowing access to its resources by countries which had been delinquent in a much larger proportion than it would under normal circumstances.

Second, the three-year period during which the country would be expected to undertake a Fund-monitored program, after which the rights it had accumulated under that program could be disbursed, was a very long period, in his view, Mr. Kafka concluded. Another issue that needed to be considered was what would happen with respect to the country's access to borrowing from, and relations with, the World Bank, the commercial banks, and multilateral creditors if it went off track its Fund-monitored program some time in the three-year period. If the Fund intended to go in the direction of the rights approach, therefore, it would have to do a much better job in

organizing support groups, so that the proportion of quota that would have to be disbursed under the rights approach could be much lower than what was implied at present, even if the Fund did not insist on charges--as well as repurchases--being met from General Resources Account resources.

Mr. Nimatallah observed that one of the central problems was the availability of resources for countries embarking on Fund-monitored programs, and their need for resources following the period of the program and their adoption of a formal Fund-supported program. Given the exceptional circumstances of those countries, access that was larger than usual would have to be expected. Therefore, special resources--he would prefer a separate subdivision within the General Resources Account, but perhaps there were other approaches--needed to be provided for the purpose, isolated from the Fund's other resources, with different access terms, different repayment terms, and, possibly, a different rate of charge.

He would prefer a Fund-monitored program to last from between one and two years, and only in exceptional circumstances for three years, Mr. Nimatallah went on. In order to solve the problem, the amount of access would have to be larger than usual, and disbursement of earned rights would have to be phased over the period of the Fund-monitored program. If repurchases were to be combined with overdue charges and settled at the same time, such enlarged access would be necessary, because the resources provided by support groups had been, and would continue to be, inadequate, if recent experience was any guide.

The Chairman said that he recalled that Mr. Nimatallah and Mr. Grosche had supported treating overdue repurchases and charges differently, which would mean that a smaller amount of resources from support groups would be needed, and lower access to Fund resources.

Mr. Grosche commented that the amount of access that was implied in the rights approach was staggering. Like Mr. Nimatallah, he had foreseen a special policy within the General Resources Account for the honoring of accumulated rights, including a special access policy for that "window". It was indeed difficult to imagine granting access of up to about 400 percent of quota to a country which had recently been in arrears to the Fund, as Mr. Kafka had observed. Consequently, he was very interested in splitting up the payment of overdue repurchases--which was absolutely necessary, and should be done without question, in his view--and the payment of overdue charges, which perhaps could be done in a way that would avoid using resources from the General Resources Account.

He could not go along entirely with Mr. Nimatallah on the matter of the time period of the Fund-monitored program, Mr. Grosche concluded. Countries which had not performed well for a long time, and which had accumulated staggering amounts of arrears, would need to pass through an extended period of implementing good policies under the eye of the Fund. He would not want to compromise on the time period required for accumulating rights; three

years would be the appropriate time period in all cases, with deviations only in extremely exceptional circumstances. It was understood that during the period of the Fund-monitored program, support groups, consultative groups, and bilateral donors would have to support the country in remaining current with obligations falling due and in financing the good policies which the country would then be implementing.

Mr. Nimatallah said that he would remind his colleagues that they wished to solve the arrears problem as fast as possible; a period of from one to two years for the Fund-monitored program therefore seemed appropriate. Perhaps it would be better to leave the time period open than to insist on a three-year period in all cases.

Mr. de Groote said that perhaps one could foresee the payment of charges temporarily in national currencies. Those repayments would flow back to the General Resources Account. Countries which received reimbursements under the burden-sharing mechanism stemming from those repayments in national currencies could guarantee to the Fund that, during the transition period, the Fund would be entitled to use the amounts of the burden-sharing reimbursements, to compensate, in effect, for the fact that the charges paid in national currencies would not be usable currencies. When the country rehabilitated itself, it would exchange its currency in the Fund for convertible and usable SDRs.

Such a system would probably not be used in practice, Mr. de Groote pointed out. It would merely act as a guarantee that, in the Fund's accounts, the repayments of charges in national currencies could be registered as resources available to be used by the Fund.

Mr. Mawakani remarked that a key problem that remained to be solved was the lack of financing from support groups for countries embarking on Fund-monitored programs. In his view, the rights approach should be discussed only after the elemental issue of adequate financing had been addressed.

The Chairman said that Mr. Kafka's observation in that connection was quite appropriate, in that the longer arrears were allowed to accumulate--especially the accumulation of charges--the more elusive was the solution to the problem, because the amount of access to Fund resources that was implied would become larger and larger.

Mr. Appetiti said that at the end of a Fund-monitored program, the country should be required to continue with a standard Fund-supported program in order to gain the disbursement of rights it had earned under the Fund-monitored program.

He was not completely comfortable with a three-year period for the length of the Fund-monitored program, but periods both longer and shorter than that could lead to other problems, Mr. Appetiti went on. Although,

as Mr. Kafka had pointed out, a three-year program would imply fairly high access in terms of the percentage of quota for a number of eligible countries, it should be noted that the very large access would actually apply to only two or three cases. Ways might be found to eliminate the high access problem in any case. For example, the country could be allowed credit for prior actions it had taken before embarking on the Fund-monitored program, which would accumulate at the start of the program, rather than at the end. Another possibility would be to allow accumulated rights to be used only against overdue repurchase obligations, and not against overdue charges. Finally, as Mr. de Groote had suggested, the Fund could require some type of collateral.

The longer the period of the Fund-monitored program and the greater the access that was allowed, the more necessary it would be to require a Fund-supported program following the expiration of the Fund-monitored program, Mr. Appetiti pointed out. By that time the country would have drawn a substantial amount of resources from the Fund, and the Fund would need to be assured that the country was following the appropriate adjustment path to ensure that Fund resources were used wisely. His chair would be in favor of lengthening the repayment period, however, taking into account the size of the disbursement in relation to the country's quota.

He did not consider the proposal to disburse periodically accumulated rights before the arrears were cleared a workable one, Mr. Appetiti continued. The use of structural adjustment facility resources to support the country during the period of the Fund-monitored program should also be ruled out, in his view.

If performance criteria were not observed under a Fund-monitored program with rights accumulation, and a waiver was not seen as appropriate, he was not certain that the staff's proposal that the member be allowed temporarily to retain its accumulated rights pending steps to put the program back on track or agreement on a new program was appropriate, even though his chair recognized that there might be situations in which events were entirely beyond the control of the country, Mr. Appetiti stated. If the Fund believed that the country deserved to retain its accumulated rights, it should also believe that it deserved a waiver.

He had an open mind with respect to the staff's observation that, depending on the length of time a country remained in arrears to the Fund during the period of the Fund-monitored program, the sequential and parallel clearance of arrears to the Fund and the World Bank might be considered, Mr. Appetiti concluded.

Mr. Mawakani commented that any approach to solving arrears needed to ensure that the country in arrears had adequate resources to support a program to rehabilitate its economy and ultimately to discharge its arrears. A Fund-monitored program should be subject to six-monthly, rather than quarterly, monitoring.

A Fund-monitored program would indeed be very costly to countries presently in arrears, Mr. Mawakani observed. The capitalization of overdue charges in the form of new Fund credits, the cost of any bridge loans that might be provided by commercial banks or other sources of financing, and the effects of the current burden-sharing mechanism all needed to be included in the cost picture. Perhaps the staff could comment on that aspect.

The rate of accumulation of rights was an item of concern, Mr. Mawakani concluded. Because he believed that a country should be given adequate time to implement the program under the rights approach, the program period should be longer than three years. With respect to repayment, he believed that the staff might consider reviewing the provisions of Article V, Section 7(d) in order to allow for a longer repayment period than that discussed in the staff paper.

Mr. Dawson remarked that although he shared Mr. Kafka's concern about the large amount of access that the rights approach implied in some cases, it needed to be recognized that, in effect, the Fund was granting even larger access through growing arrears. He thus did not attach such a high priority to that issue.

In raising the issues of rights accumulation, support groups, and the possibility of separating repurchases and charges, it had become easy to lose sight of the financing aspect, as Mr. Mawakani had mentioned, Mr. Dawson observed. In avoiding discussing financing, it might appear--at least from the discussion so far--that the Fund was considering a direct use of General Resources Account resources. His chair had strong reservations about such an approach. Financing for the rights approach should come from special sources--the structural adjustment facility, the enhanced structural adjustment facility, partial sales of Fund gold, or expanded burden sharing, for example.

With those qualifications, he broadly supported the rights approach, Mr. Dawson went on. The minimum time period for the Fund-monitored program should be at least three years, and longer for larger arrears cases. The period should be long enough to ensure that the reform efforts tackled the fundamental economic problems that had led to arrears in the first place. A period longer than the typical Fund shadow program should be required in order to avoid the problem of moral hazard, because it was likely that the access of some countries to Fund resources under the rights approach would be larger than what was allowed under the current enlarged access policy. The Fund should be assured that the commitment to the appropriate policies was firmly in place. He hoped that in the event, the rights approach would not be necessary for a number of countries currently in arrears--Panama was such an example.

Accumulated rights should be used to discharge both overdue charges and overdue repurchases, Mr. Dawson stressed, because the obligations the country undertaking the Fund-monitored program would be expected to fulfill

would be quite substantial, as Mr. Mawakani had pointed out; the staff might indicate what those obligations would be for 1990-91, for example.

The steps that would be taken if a country did not perform satisfactorily under the Fund-monitored program needed to be given serious consideration, Mr. Dawson stated. The loss of accumulated rights should occur. Thought should be given to other remedial measures as well, such as the triggering of an automatic declaration of noncooperation or suspension of voting and related rights, or perhaps a reduction in voting rights in parallel with the level of overdue repurchases, or the extent to which the program was judged to have gone off track.

The Board should continue to look at the possibility of extending the repayment period under the subsequent Fund-supported program, Mr. Dawson concluded. Also, he would like the staff to provide an idea of what an appropriate rate of charge would be on resources disbursed under the rights approach.

Mr. Evans said that he had noted that Mr. Dawson had caught the presumption in the staff paper that the rights approach might be limited to the worst cases. He agreed that some of the other cases could be settled in the context of existing arrangements, but once a rights approach was introduced, he wondered how its application could be limited to particular cases. To set as the criterion the degree of severity of the arrears would simply create a second level of moral hazard. He wondered whether the staff had some thoughts on that point.

In relation to Mr. Dawson's comment on what should be covered by the rights approach, it needed to be borne in mind that, during the period of the Fund-monitored program, arrears and other financial obligations--outstanding obligations plus charges plus accruing obligations--would still have to be covered by the country itself through support group or bridge financing, Mr. Evans pointed out. What was to be put into the rights approach did not seem to relieve that financing problem.

The Chairman asked whether Mr. Dawson could be more explicit about the circumstances in which the time period for the Fund-monitored program should go beyond three years.

Mr. Dawson remarked that in theory, the rights approach would be available to every country in arrears. However, it might be expected that countries would generally prefer not to go that route, tending to leave only the worst and largest arrears cases to follow the rights approach. A three-year time period would probably not be sufficiently long, in the worst cases of arrears, to judge the solidity of the program. The problem of financing the very large arrears cases could also not be ignored. He would not be attracted to the idea of front-loading disbursements of accumulated rights or of giving too much credit to prior actions, although he recognized that some flexibility might be useful on those points.

The Director of the Exchange and Trade Relations Department stated that the staff had indeed assumed that countries which had the option of clearing their arrears through a support group in a fairly short space of time would choose it. The case of Guyana came to mind in that connection. The staff had thought that to be a reasonable assumption, although it recognized that some members which might have the option of using other methods to solve their arrears might still opt for the rights approach.

The three categories of financing that were needed in arrears cases were, first, financing for the economic program that would be carried by the member with help from support groups and other agencies; second, financing to ensure that the member kept current with respect to repurchases and charges falling due; and third, financing to allow a member to begin dealing with accumulated arrears, the Director noted. The rights approach was designed to help deal with the accumulated arrears, thereby reducing one of the burdens which currently fell on the support group--although possibly not the heaviest one, nor the most difficult. The rights approach could also serve to protect the Fund, because, if past experience was any guide, there could be a tendency for a support group which began to find it difficult to secure the required finance to load more and more onto the Fund, so that the Fund ended up dealing not only with the accumulated repurchases, but also the accumulating charges and accumulating repurchases.

Mr. Kafka commented that it was all very well to discuss a period of three years as the minimum period in which a country might be expected to solve its structural problems, but that begged the question of the source of the money that would be needed not only to support the economic program in that period, but also to repay the Fund afterward.

He recalled that Mr. Dawson had reintroduced his ideas about suspension of membership in relation to the nonobservance of performance criteria in Fund-monitored programs, and about the progressive reduction of voting rights, Mr. Kafka remarked. The latter encompassed the idea that when a country's voting rights fell to zero, automatic expulsion from the Fund would result. Therefore, it appeared that, if those ideas were to be applied to a country following--or rather, deviating from--a Fund-monitored program, a situation might result in which a member would be expelled from the Fund notwithstanding the fact that decisions on suspension or compulsory withdrawal--which required an 85 percent majority for approval--had not been taken, and perhaps had not even been considered by the Executive Board.

Mr. Dawson remarked that he had intended that the Board consider initiating a procedure of expulsion once voting rights fell to zero. It was clear that maintaining support group financing for the country's program under the rights approach and keeping the country current with the Fund would be more difficult over a longer period of time, and in that respect, it was true that a three-year Fund-monitored program might be harder to maintain than a one- or two-year program. However, in his view, any real effort at reform was unlikely to end after one year, and a one-year support

group for any country sounded a bit unrealistic in any case. A three-year period therefore seemed to be about the right length. The difficulty of securing financing for a three-year program should not be underestimated, as Mr. Mawakani had stressed, but genuine reforms could probably not be implemented in less time.

Mr. Lombardo observed that the rights approach would not be workable without a secure framework for financing the Fund-monitored program.

Mr. Evans stated that although all countries in arrears would be eligible for the rights approach, the Fund's objective should be to have as small--and diminishing--a number as possible under it. He wondered how the Fund should go about creating incentives to encourage countries to solve their arrears outside of the rights approach. For example, Guyana was at present on the verge of solving its arrears problem via the support group process and bridge finance, and would thus be able to take advantage of other Fund programs sooner than the period of three, four, five, or even six years that would be implied under a Fund-monitored program with accumulated rights. The rights approach should be designed so that those countries with smaller amounts of arrears which were attempting to solve them through other means were not led to the rights approach instead. One way would be to ensure that there would not be concessional financing at the end of a succesful rights program that was followed by refinancing and new programs. Reality might suggest that the repayment period for credit extended under the rights approach be lengthened, but it would be important not to make financing under the rights approach more attractive than that extended to other countries, especially those countries which were attempting to solve their arrears problem by other means.

The Chairman stated that it would be important to ensure that arrears were settled as soon as possible, and that the program did not merely encourage a lengthening of the period of arrears. A country should have the option of choosing the rights approach if it wished, in his view, but if it could do without that approach and still solve its arrears, that was all to the good.

Mr. Grosche commented that a country should become eligible for the rights approach only after a certain period of time had elapsed--and in terms even of a number of years--after the declaration of ineligibility. A member should be encouraged to repay the Fund as quickly as possible as a matter of principle. The fact that a country's arrears would continue to increase during that interim period would serve as a disincentive to countries to allow arrears to persist. The rights approach would provide the member with a way to remove the arrears, but at a premium. At least one year should elapse before a country would be allowed to begin negotiations with the Fund on a Fund-monitored program with the accumulation of rights, in his view.

Mr. Evans said that he wondered whether it would be appropriate for the Fund to allow a member in arrears in effect to relax for an interim period before it was placed under the rights approach. In his view, that introduced a second level of moral hazard, which should be avoided through a higher level of conditionality under the rights approach, and also because the Fund would be increasing its exposure to those countries at the end of the rights accumulation period. The Fund must expect that a country emerging from a Fund-monitored program would be more viable than it had been before, which implied a stronger program with a higher level of conditionality.

Mr. Appetiti commented that the rights approach might undermine the whole support group process. Countries that might otherwise contribute to support groups might encourage countries in arrears to follow the rights approach, because then the creditors would not be called upon to provide as much financing. An additional burden would be placed on the Fund instead.

The Chairman said that the rights approach ought to be seen as an incentive for countries to enter into an arrangement with a support group, thus strengthening the overall arrears strategy. Countries should retain the option of following the rights approach--which surely was not free of certain disadvantages from the country's perspective--or not. In any event, the Fund's objective should be to encourage countries in arrears to settle them and re-establish normal relations with the Fund and with the international financial community as soon as possible.

Mr. Dawson said that although the rights approach would have positive reinforcements in the form of the financing and clearing of arrears that would occur at the end, it would also have certain negative reinforcements, such as an increased level of conditionality, for example, which he would not oppose. In any case, he did not believe that the rights approach would necessarily create an incentive for countries in arrears to sit back and relax, because arrears would continue to accumulate, with or without a rights program.

One of the key problems with support groups had been the difficulty of attracting broad-based participation, Mr. Dawson noted. The rights approach would address that problem by reassuring potential contributors that the country was likely to deal with its fundamental economic problems through a Fund-monitored program. The rights approach need not undermine the support group process.

Mr. Clark said that any arrears strategy should provide, first, incentives for members not to fall into arrears, and second, incentives for members already in arrears not to delay repayment. The rights approach addressed only the second incentive. Other elements of the arrears strategy would have to address the first. In that sense, the entire strategy and the balance of incentives and disincentives it provided needed to be seen as a package.

Mr. Grosche said that the rights approach that was being considered did not preclude the possibility that a country that had been in arrears to the Fund for one or more years would not, when threatened by the Board with a declaration of ineligibility, apply for a Fund-monitored program under the rights approach and have its arrears refinanced by a support group. The Fund should not permit such a possibility, in his view. The member should be required to deal with its arrears instantly, otherwise it should be pursued by the Fund, through a series of steps of increasing severity, until it discharged them. Only then could it re-establish good relations with the Fund. The real moral hazard was that the rights approach might encourage more members to enter into arrears.

The Chairman said that the rights approach should be seen in the context of the whole package of measures in the arrears strategy, including preventive and deterrent measures. Once a country entered in good faith on a Fund-monitored program, a program that would probably have a somewhat higher degree of conditionality attached to it, it would not be appropriate for the Fund to add, in effect, to the conditionality by lengthening the program period beyond what would be needed to establish viability. The length of the program period should be linked to the accumulation of the rights needed to clear arrears and to set the country back on a firm course, and not to the period of time the member had been in arrears. Of course, a country in arrears to the Fund for a short period--say, two months--would not be entitled to request a Fund-monitored program; it would be expected to find other ways to clear those arrears first. Defining the exact time period would be difficult, however.

Mr. Nimatallah commented that the rights approach would be designed for countries currently in arrears, and not for future cases of arrears, which, as Mr. Posthumus had said, should not arise in light of the deterrent measures that the Fund was implementing.

The Director of the Exchange and Trade Relations Department said that the staff had assumed that the rights approach would be available only to the 11 countries currently in arrears. Even then, in practice, the 4 or 5 members which it could be reasonably expected would solve their arrears in other ways should be subtracted from the 11. The strength-ened arrears strategy should prevent future arrears cases.

Mr. Grosche commented that it would be important to make it clear in the guidelines on the rights approach that the approach would be limited to the members to which the Director of the Exchange and Trade Relations Department had referred, so that the door would not be left open for its use by other members which might fall into arrears in the future. He would be very satisfied with such a precise limitation. But in light of what the Director had just said, it would appear that the Board would be pursuing an amendment of the Articles of Agreement for the sake of only a small number of countries.

Mr. Cassell noted that he had always assumed that the rights approach would be limited to existing arrears cases.

He had found the staff paper very helpful, Mr. Cassell stated, as it laid out in quantitative terms the effects of a rights approach. It elicited the sort of comment that Mr. Kafka had made at the beginning of the session, that the implied level of access was clearly not acceptable. The rights approach would surely not be a wholly adequate answer to the arrears problem. If an agreement could be reached on the amount of access that would be allowed, however, perhaps the Board would have a better idea of how much of the problem the approach would solve. The rights approach might not be the solution for the smaller arrears cases, but it might make a significant contribution in the worst cases; it was thus worth pursuing further.

The Board would be discussing in the future the filling of the financing gap, Mr. Cassell observed. In that connection, the sequential clearing of arrears might be looked at more closely, on a case-by-case basis. Agreement on tolerable access limits would be very necessary, as he had said before.

He was hesitant about a freeze on any particular time period for the length of the Fund-monitored program, Mr. Cassell went on. There were clearly some countries which would not require a program of three years' length--Honduras came to mind--but there were other cases in which even three years might not be adequate. For example, Sudan would not have accumulated enough rights to clear its arrears even after a three-year Fund-monitored program, according to the staff, which again suggested the case-by-case approach. If the Fund-monitored program were to be of the same duration in all cases, then the question of differential levels of access from country to country arose, and the issue of uniformity of treatment, in his view.

Mr. Arora observed that the rights approach was meant to deal with the problem of overdue repurchases. Overdue charges were being dealt with through the burden-sharing mechanisms. He believed that when that distinction was made, the rights approach could be seen to be a more viable operation.

He agreed with what Mr. Dawson had said about the length of time required for adjustment, and with Mr. Cassell about the access problem that arose, Mr. Arora concluded. The fact of the matter was that a special framework would be required to deal with the problem, under which a somewhat longer period for adjustment in combination with a somewhat higher level of access, depending on the circumstances, could be accommodated. It was clear that some countries--Liberia and Sudan, in particular--would need more time to solve their arrears under the rights approach.

Mr. Fogelholm said that he also would like to thank the staff for having produced a very clear document on the rights approach that spelled out its

workings and its effects on the needed financing, depending on the application of different amounts of access.

He would like to outline what might be considered extreme cases in that regard, Mr. Fogelholm went on. Using the rights approach and maintaining normal access policies would mean extremely long--perhaps even unrealistically long--monitored programs, unless the maximum annual access was utilized. That approach would also require additional external financing and renewed efforts to activate the support groups. The positive effects of that approach were that the Fund would be applying the principle of equal treatment, and there would be no problems or moral hazard.

Using the rights approach and throwing normal access policies overboard would mean shorter Fund-monitored programs, but would clearly require more financial involvement from the Fund, Mr. Fogelholm pointed out. If applied as a general policy, it would certainly introduce the unequal treatment of members and create a moral hazard. For example, incentives to clear arrears would not be improved if, by delaying the payment of arrears, countries could expect to receive double the amount of access. Such access would undoubtedly look strange in the light of the recent discussions on Fund access policy, during which voices were raised to the effect that access to Fund resources should be zero in certain cases when the Fund-supported program was not considered strong enough. Also, if the Fund were to increase considerably its own share of financing, it would be even more difficult than it was at present to obtain additional financing from the support groups.

If such an approach were adopted, the only conclusion that could be drawn was that existing overdue cases should be isolated, and that those policies should only be applied in those specific instances, Mr. Fogelholm concluded. He did not believe that Mr. Posthumus's proposal for periodic disbursements of accumulated rights should be dismissed out of hand. The rights could be disbursed into a special interest-bearing account that was not at the disposal of the member, but which would nevertheless provide some additional financing to the member and have the effect of phasing the necessary repayments later on.

The Chairman said that because accumulated rights had no financial value they could not be made to bear interest. An amendment of the Articles would probably be required to give a financial value to accumulated rights.

Mr. de Groote commented that speaking about equal treatment vis-à-vis countries in arrears was something of an anomaly, in his view. The Fund already treated such countries differently. In a normal Fund-supported program, the country received Fund resources while implementing the program; in the case of a country in arrears following a Fund-monitored program, the country would receive not resources, but only rights, from the Fund, and moreover would effectively have to secure real finance from other sources in that period to support its program. That being said, he was not so

disturbed about allowing countries in arrears following a Fund-monitored program with the accumulation of rights to have increased access to resources at the end of the program. Such increased access might also be considered entirely appropriate, because the country would have had to have taken exceptional measures to rehabilitate itself, for which it should be rewarded. Like Mr. Nimatallah, he believed that such countries could be treated in a separate category, which would allow special access to the general resources of the Fund.

The Chairman said that another point supporting Mr. de Groote's perspective was that the Fund was attempting not only to eliminate past arrears but, with preventive and deterrent measures, to create the conditions that would ensure that the re-emergence of arrears would be avoided in the future.

Mr. Nimatallah remarked that the Board had overlooked the number of layers of financing that would be required in any of the arrears cases under the rights approach. First, financing would be needed during the period of the Fund-monitored program to support the program; second, financing would be needed to freeze the arrears at the current level and to keep the member current with the Fund; finally, the formal Fund-supported program that would follow the disbursement of rights and the clearance of arrears would need to be financed. Thus, the amount of access would be a good deal higher than the 160 percent of quota Directors had spoken of. Because of the amount of financing that was implied, resources in the General Resources Account and in the enhanced structural adjustment facility that remained unutilized would probably have to be mobilized.

Mr. Grosche said that no fresh money should be forthcoming from the Fund in the face of outstanding arrears. In his view, therefore, neither the periodic disbursement of accumulated rights, nor the use of structural adjustment facility resources for keeping a country current following a Fund-monitored program, should be allowed. Of course, once the rights were activated and the arrears cleared, a Fund program could be initiated with Fund resources, as well as enhanced structural adjustment facility resources for those countries eligible for them.

Mr. Kabbaj stated that he found the rights approach an extremely imaginative one which might contribute to solving the few cases of protracted arrears. Since a Fund-monitored program would not be easy for any country to follow, he saw no problem of moral hazard. He could not imagine a country falling purposely into arrears with the Fund in order to be engaged in a three- or four-year Fund-monitored program without Fund resources.

A subtle objective of the Fund-monitored program appeared to be to ensure that, at some stage, the Fund got its money back, Mr. Kabbaj observed. Countries embarking on adjustment programs needed to be able to convince their populations of their necessity, however, and in the case of a Fund-monitored program the Fund would be dealing with countries which had

not adjusted--and in fact had lived by not adjusting--for years. It was unlikely that those hard-core cases would be able to begin implementing such a program, and from that perspective, the rights approach might not be very practical. Another problem was securing adequate financing for a Fund-monitored program. The origin of such financing was hard to perceive; the reaction of the World Bank, other official creditors, and support groups in that regard would be hard to gauge in advance.

Mr. Finaish stated that he saw merit in the rights approach, although like others, he saw the need for balance between the period of accumulating rights and the implied access relative to quotas. He was therefore open to the suggestions to augment General Resources Account resources by other means, as the Managing Director had suggested in his statement at Informal Session 90/8 on February 7, 1990. Principally, he believed that the period of Fund-monitored programs and rights accumulation should be a flexible one; in that respect, he shared the views of the Managing Director and Mr. Cassell.

The financing of the rights approach would be either totally or largely with general resources, Mr. Finaish observed. He wondered whether the rate of charge that would apply would be that on use of the Fund's regular facilities, or a concessional rate. If it was the first, the possibility that debtors might fall into arrears again could not be ruled out. If it was the second, he was not certain of the legal implications of assigning a concessional rate to General Resources Account resources. Even if it were possible legally, there would be implications for the Fund's income position and for the charges on regular facilities, as the users of those facilities would pay higher charges. Perhaps the staff could comment on those points.

The Director of the Exchange and Trade Relations Department stated that the rate of charge on disbursed accumulated rights would be equal to the rate of charge on the use of General Resources Account resources. The rate of charge would be an annual burden on the country and form part of its financing gap, which would have to be financed by the country itself, other creditors, or by other means.

Mr. Grosche said that perhaps longer repurchase periods might be considered for rights approach resources.

Mr. Nimatallah remarked that in light of the ramifications of the arrears problem, there might be some justification in creating an entirely new structure for the rights approach, in which the rate of charge on use of resources would be lower than usual, the repurchase period would be longer than usual, and the total amount of access higher than usual. As an example of the dimensions of the problem, in the case of Sudan about SDR 2 billion would be required to solve arrears, support a Fund-monitored program and initiate a formal Fund-supported program at the end. The Fund would have to do everything it could to ensure that its policies did not in fact merely

add to the country's final burden through high rates of charge and an unrealistically short repurchase period.

Mr. Grosche said that although he sympathized with the plight of countries in the type of situation described by Mr. Nimatallah, he would find it difficult to approve providing resources through the General Resources Account that were subsidized by other Fund debtors in a semi-permanent fashion. Moreover, it would be difficult to request the debtors and creditors participating in the burden-sharing arrangements to continue to make contributions to it, in effect, through reduced charges on rights approach resources, even after the arrears countries had cleared their arrears and were, assumedly, following the appropriate policies under the Fund's advice. He wondered whether it would even be legally feasible.

The financing for a special policy within the General Resources Account to support the rights approach and solve arrears might come from an agreement by the Fund's members to provide credits equal to one percent of their quota share, Mr. Grosche suggested. If certain members wished to make those credits available at a reduced rate to the Fund, then the savings could perhaps be passed on to countries following the rights approach through a reduced rate of charge on resources acquired through the rights approach. He was uncertain whether lending to the Fund at a reduced rate of interest would find much support among potential contributing members, however.

Mr. Arora said that a one percent contribution in relation to quotas as a means of effecting a reduced rate of charge on rights approach resources would impose a heavy burden on the entire membership. It would imply a subsidy, financed by the membership, on the use of those resources. He was not certain that the discussion had yet progressed to the point where talk of a subsidized rate of charge was really practical. After all, the disbursement of accumulated rights would not become operational in any case until several years into the future. In his view assembling an adequate financing package for countries following the rights approach was a more immediate priority.

Mr. de Groote observed that Mr. Grosche's suggestion about a one percent contribution in relation to quotas to effect an interest rate subsidy on rights approach resources could relate either to a contribution directly from the treasuries of member governments, or from the Fund. Perhaps the Fund could agree to use part of the 25 percent of the quota increase that would be paid in under the Ninth General Review for a special purpose like the subsidy.

Mr. Grosche said that he had had in mind a loan from member countries to the Fund along the lines of the loans the Fund had secured from the Saudi Arabian Monetary Agency (SAMA). The loans would be backed by the resources of the General Resources Account, and would be counted as a reserve asset in the central bank accounts of members. Since the loans would be a monetary asset of the member, it would be difficult to secure them at subsidized

rates of interest. Nevertheless, certain members might wish to provide the loans at a reduced rate of interest on a voluntary basis. He expected, however, that most members would not be able to choose to make a low-interest loan, which would come out of reserves and would therefore have to bear a yield at least close to market rates.

In response to a question from Mr. de Groote, Mr. Grosche explained that the funds raised through the loans would be used to finance only the accumulated rights that would be disbursed after the arrears had been cleared. Since resources from the General Resources Account should not be made available to countries still in arrears, the loans could not be used to finance the Fund-monitored program.

Mr. Nimatallah recalled that the supplementary financing facility had had a subsidy account to effect a lower rate of charge. Perhaps a subsidy account for rights approach resources could be funded by transferring to it the resources remaining in the structural adjustment facility which would have been available to the countries currently in arrears, to lower the rate of charge on rights approach resources. The structural adjustment facility itself would remain, to fulfill its original purposes.

Mr. Dawson commented that, for purposes of disbursing resources, a better definition of clearing arrears was needed. Mr. Grosche's position would seem to require that the member in arrears be mostly responsible for clearing them, whereas the position of other speakers appeared to be that the Fund should have some hand in the process. He was skeptical about voluntary schemes along the lines of Mr. Grosche's proposal; a similar system had not worked very well in the case of the Polish Stabilization Fund. The proposal of the United States for the sale of part of the Fund's gold could also be part of a plan to lower the rate of charge on rights approach resources.

Mr. Fogelholm observed that since the remaining structural adjustment resources served as collateral for the enhanced structural adjustment facility, he did not believe that they could be used for reducing the rate of charge on rights approach resources. The idea of a one percent of quota contribution that Mr. Grosche had put forward might be attached more appropriately to the quota increase than made into a voluntary contribution.

Mr. de Groote said that perhaps the contribution of one percent of quota for lowering the rate of charge on rights approach resources could be made a part of the resolution on the Ninth General Review of Quotas, and in that way, made compulsory, rather than voluntary. It could become an integral part of the quota increase by linking an increase in quota to such a voluntary contribution. A member would have the option of either accepting the increase in its quota and committing one percent to the reduction in the rate of charge on rights approach resources, or not. Such a structure would preserve voluntarism, but in a somewhat more compulsory way, as was common in many institutions like the Fund.

The Chairman commented that such an approach would run the risk of having the increase in quotas turned down by the Governors.

Mr. Grosche said that he believed that Mr. Fogelholm was correct about the use of the structural adjustment resources as collateral for the enhanced structural adjustment facility. He was not aware that Mr. Dawson's gold mobilization idea had incorporated the idea of using the proceeds of a sale to invest for the purpose of providing an interest rate subsidy; rather, he had thought that the proceeds would be used to fund the rights themselves.

Mr. Dawson said that because money was fungible, a gold sale could have the indirect effect of lowering the rate of charge on rights approach resources. Money from gold sales would probably carry a lower cost to the Fund than loans from national treasuries. At the least, gold sales would lower the average cost of funds. For example, the Trust Fund had had an interest subsidy because proceeds for it had come from gold sales.

The Chairman said that if gold were not part of the final package, the Fund would need to find an alternative investment that would yield about SDR 70-80 million a year for the purpose of the arrears strategy.

Mr. Evans commented that the fact that only 11 countries were being dealt with under the rights approach might dictate in part what kind of funding for the approach should be considered.

The Chairman remarked that the two key issues remaining to be decided were, first, the way to utilize any voluntary contributions coming out of the Arora proposal, and second, how to involve the so-called free riders which did not contribute to burden sharing at present. Those issues would be taken up on the following day.

The Director of the Exchange and Trade Relations Department said that the staff had not tried in its paper to disguise the dilemma of extremely high access which the rights approach implied. However, the extent of access depended very much on the case. In the case of Guyana, for example, if Guyana were to follow a Fund-monitored program for nine months, it would have available to it under a Fund arrangement at the end a drawing equal to about 125 percent of its quota; if that were prorated for a period of one year, access would be equivalent to 167 percent of quota. On the other end of the spectrum, there was Sudan. Crude calculations suggested that after 19 years Sudan's obligations to the Fund could be equal to SDR 4 billion; thus, the Fund was on a course which, in the case of Sudan, implied extraordinarily high access.

The use of structural adjustment facility resources to provide an interest rate subsidy on rights approach resources would require a decision

by the Board, a change in the ESAF Trust instrument, and the agreement of each and every creditor to the enhanced structural adjustment facility, the Director pointed out.

Mr. Kafka commented that he did not oppose the rights approach, but had thought that it was a little odd. Perhaps it would be simpler merely to call it rescheduling.

The Director of the Exchange and Trade Relations Department said that in a sense he agreed with Mr. Kafka. The Articles of Agreement in fact allowed for rescheduling, but the use of that provision had not met with a consensus in the Executive Board.

Mr. de Groote said that it was not appropriate to mention "rescheduling" which moreover was not what the Fund was pursuing under the rights approach, because rescheduling implied some degree of automaticity and nonconditionality. After all, the Fund would be monitoring the country in arrears under the proposed approach. Perhaps the term "performance related arrears management" would be more accurate.

The Chairman remarked that the Fund was in a somewhat paradoxical, and certainly one of the most difficult, positions it had ever been in, yet it did not wish to use the instrument provided by its founders for getting out of it.

Mr. Kafka commented that in his view, the concept of rescheduling need not exclude the possibility of conditionality.

Mr. Nimatallah said that many Directors had believed at first that arrears would be resolved in the fullness of time, without the Fund having actively to do anything about them. That belief had proven to be false. What the Fund was trying to do in the arrears strategy was not strictly rescheduling, in his view, because the Fund was attempting not only to get its money back, but to re-establish the economies of the members in arrears, and taking precautions to assure that arrears would not recur.

Mr. Dawson said that in his view, the key moral hazard was the encouragement of, in effect, repeated rescheduling.

The Chairman said that that moral hazard would be avoided by isolating the existing 11 cases of arrears and pursuing deterrent measures.

In concluding the discussion, the Chairman remarked that the staff would circulate a paper on the ideas that Directors had put forth, including Mr. Arora's proposal, the burden-sharing questions, and a definition of noncooperation. The points made by Mr. Finaish and Mr. Arora would be taken into account in particular. In his view, noncooperation meant not paying the Fund and having bad policies, but further elaboration of the definition

might be appropriate. Directors might also wish to address the question of arrears clearance in the context of Fund-monitored programs.

It was clear that Directors wished the rights approach to figure prominently in the Fund's overall arrears strategy, it being understood that the approach would be limited to the 11 current arrears cases, the Chairman said. It was the sense of the discussion that the possibility of resorting to compulsory withdrawal--at some time in the future, whatever the decision on suspension of voting and related rights of membership--should not be excluded.

LEO VAN HOUTVEN
Secretary

Note on the Suspension of Voting and Related Rights of Membership

At a recent informal meeting of the Executive Board on the strengthening of the Fund's cooperative strategy on overdue obligations (1/27/90), Executive Directors discussed a possible amendment of the Articles that would give the Fund the power to suspend the voting and certain related rights of a member. In that context, the staff was asked to identify the main issues that would need to be considered in connection with such an amendment.

1. Scope of the suspension

The possible amendment that was discussed contemplates the suspension of the member's voting rights and certain related rights. The following considerations should be noted in this respect:

(a) The amendment would be directed not at the suspension of all rights of membership generally, but at the suspension of specific rights, such as voting rights. This follows the approach that was presented in the staff paper of 1989 on "The Issue of Suspension of Membership" (SM/89/127, 6/28/89). Such a suspension is narrower than the suspension of membership rights in Article VI, Section 2 of the World Bank's Articles. In the Fund, a suspension of all rights of membership would present substantial difficulties due to the particular structure of the Fund; these were discussed in detail in an earlier staff paper on "Suspension of Membership in the Fund--Legal Aspects" (SM/87/229, 8/25/87).

(b) Under the Articles, there is separation between the General Department and the SDR Department with respect both to sanctions (Article XXIII, Section 2(f)) and to voting rights (Article XXI(a)); accordingly, the suspension discussed in this note would not apply to decisions on matters that pertain exclusively to the SDR Department. A separate provision on suspension of voting and related rights of participants could be considered for decisions on matters that pertain exclusively to the SDR Department.

(c) In considering the issue of suspension of members' rights in the Fund, the special status of Executive Directors and Governors must be recognized. Specifically, even though Executive Directors and Governors can be expected to be mindful of the interests of the members that have appointed or elected them, they are not, as a legal matter, representatives of these

members; 1/ rather, they are officials of the Fund. As such, they act and speak on their own behalf, and do not bind the members to the views or actions that they take, as representatives would (see SM/87/229, p. 29). Therefore, Executive Directors and Governors, when they vote, do not exercise the voting rights of the members that have appointed or elected them, but exercise instead their own voting rights. It follows that the suspension of the voting rights of the members would not by itself suspend the voting rights of the Governors and Executive Directors they had appointed or elected. To achieve that end, a separate provision would be necessary.

Therefore, in considering the scope of a possible amendment on the suspension of voting and related rights, there is a need to distinguish: (i) between the rights of the members themselves and the rights of the Governors and Executive Directors appointed or elected by these members, 2/; and (ii) between voting rights and other rights that, although related, are distinct from voting rights.

a. Suspension of rights of members

(i) Voting rights

The suspension of the voting rights of a member would suspend:

- the right of the member to participate in elections of Executive Directors (Article XII, Section 3(b)), and

- the right of the member to vote on proposed amendments of the Articles (Article XXVIII(a)). 3/

1/ There may be circumstances in which Governors and Executive Directors may be called upon to act as representatives of members. For instance, a member that is not entitled to appoint an Executive Director under Article XII, Section 3(b) may designate a representative to attend a meeting of the Executive Board when a request made by, or a matter particularly affecting, that member is under consideration. When a member designates for that purpose the Executive Director that it has elected, the latter acts as a representative, in the legal sense, of that member (see SM/87/229, p. 30).

2/ Appropriate references to Councillors appointed by members should be included in such an amendment, in case the Board of Governors decided to call into existence the Council referred to in Article XII, Section 1 (see also Schedule D).

3/ The provision on suspension of voting rights would presumably specify that, during the period of the suspension, the number of votes allotted to the suspended member would not be included in the calculation of the total voting power. Similarly, it could provide that a suspended member shall not be counted for purposes of Article XII, Section 2(c), under which meetings of the Board of Governors shall be called whenever requested by fifteen members.

In connection with the latter, the question would arise whether the suspension should extend not only to the right of the member to participate in votes on proposed amendments that require the acceptance of a majority of members, 1/ but also to the member's right to vote on proposed amendments to one of the three provisions of the Articles for which the consent of all members is required. 2/ Considering that the protection given to members concerning amendments of these provisions is akin to a veto right, 3/ and considering the nature of the protected provisions, it would seem reasonable to exclude amendments of these provisions from the scope of a suspension of voting rights.

(ii) Right to appoint a Governor or an Executive Director

While the suspension of the voting rights of members would suspend the right of members to participate in elections of Executive Directors, it would not by itself suspend the right of members that may appoint Executive Directors to appoint such Directors, because the right to appoint is not a voting right. For the same reason, it would not suspend the right of members to appoint Governors.

Therefore, additional provisions on the suspension of these rights would be necessary, if they are to be subject to suspension. Such additional provisions would have to be carefully examined in the light of their possible impact on other provisions of the Articles. Consider, for example, the right of a member with one of the five largest quotas to appoint an Executive Director (Article XII, Section 3(b)). To suspend that right could create a conflict with the requirement in the same provision of the Articles that the Executive Board be composed at all times of at least 20 Executive Directors (or the number otherwise decided upon by the Board of Governors). 4/ To achieve this total, in the interest of the Fund, the appointment of an Executive Director by the respective five members is not only a right, but also an obligation, under the Articles. Means can be suggested for avoiding the resulting dilemma. For example, Article XII, Section 3 could be amended to provide that, in case the appointment right of a member with one of the five largest quotas is suspended, the member with

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1/ In order to come into effect, an amendment of the Articles must be accepted by three-fifths of the members having 85 percent of the total voting power (Article XXVIII (a)).

2/ These are: (i) the provision that gives a right to each member to withdraw from the Fund at any time; (ii) the provision that specifies that no change may be made in a member's quota without its consent; and (iii) the provision whereby the par value of the member's currency may not be changed except on the proposal of the member (Article XXVIII (b)).

3/ To this extent, it is comparable to the requirement of the consent of the member for a change in its quota (Article III, Section 2(d)) or for the borrowing of its currency by the Fund (Article VII, Section 1).

4/ The consequences of the suspension of an Executive Director appointed under Article XII, Section 3(c) may also have to be examined.

the sixth largest quota would then have the right (and the obligation) to appoint an Executive Director. Even then, additional questions would have to be addressed, such as the effect that the termination of the suspension would have on the status of the Executive Director that was appointed by the member with the sixth largest quota.

b. Suspension of rights of Governors and Executive Directors

(i) Voting rights

While Governors and Executive Directors are officials of the Fund and not the representatives of the members that have appointed or elected them, the views that they express can be expected to reflect the interests of their constituencies. Accordingly, it could be argued that the suspension of the voting rights of a member should be accompanied by the suspension of the voting rights of the Governor and Executive Director appointed or elected by the member. As noted above, a specific provision to that effect would be necessary. Under such a provision, the Governor appointed by the member and the Executive Director appointed or elected by the member would be barred during the period of the suspension from casting the number of the votes allotted to the member. This would mean, for an Executive Director who had been elected by more than one member, that he would be able to cast only the votes allotted to the nonsuspended members of his constituency. As for an Executive Director who had been appointed, he would not be able to cast any vote. The Governor for a suspended member would also be unable to cast any vote during the period of the suspension. 1/

(ii) Right to attend and express views at Board meetings

The suspension of the rights mentioned above would prevent the suspended member from electing or appointing a new Governor or Executive Director, and it would also prevent the Governor and Executive Director already appointed or elected by the suspended member from casting the number of the votes allotted to it. It would, however, not prevent the Governor or Executive Director from attending meetings of his respective Board (or of committees of such Board) and expressing views during these meetings. 2/ Thus, a suspension of both the voting rights of a member and those of the Governor and Executive Director for the member would not necessarily prevent the suspended member from participating in, and exercising influence on, the decision-making process in organs of the Fund, and, in particular, in the

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1/ Such a suspension would prevent the Governor and Executive Director from voting in the Board of Governors and the Executive Board, respectively, and from being accounted for in any committee of these Boards.

2/ Similar questions would arise with respect to the Interim Committee. An amendment of the Articles would, however, not be required, since the Interim Committee was established, not by the Articles, but by a resolution of the Board of Governors.

Executive Board, where decisions are generally adopted on the basis of the sense of the meeting rather than by a formal vote. 1/ The question arises, therefore, whether, in addition to the voting rights of the Governor and Executive Director for the suspended member, their rights to attend meetings of their Boards and to express their views at these meetings should also be suspended. 2/

The suspension of the right to attend and speak at meetings would raise a number of difficult issues, however, particularly as regards Executive Directors who had been elected by more than one member. In the case of such an Executive Director, the suspension of his right to attend and speak at meetings would have adverse effects not only on the suspended member, but also on the nonsuspended members of his constituency. Indeed, this Executive Director would then be unable to reflect the interests of the nonsuspended members of his constituency in Board meetings and to cast the number of the votes allotted to these members in votes on proposed decisions by the Executive Board. In effect, the suspension of one member of the constituency would result in a partial suspension of all the members of the constituency. One possible solution would be to provide that, in case of suspension of such a member, the tenure of the Executive Director who had been elected by that member would be terminated and that a new election would then take place without the participation of the suspended member. In that event, however, there may be additional consequences, in that the new Executive Director would not be the Executive Director for the suspended member in any way. 3/ In addition, there would be the question of reintegration of the member into a constituency when the suspension of the member is terminated. Would there be a further election of an Executive Director in order to accommodate the previously suspended member, or would the member

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1/ In ascertaining the sense of the meeting under Rule C-10, however, the Chairman would disregard the voting power of the suspended members.

2/ Under Article XII, Section 3(j), any member that is not entitled to appoint an Executive Director as a member with one of the five largest quotas may send a representative to attend any meeting of the Executive Board when a request made by the member or a matter particularly affecting the member is under consideration. If the rights of the Governor and Executive Director to attend meetings of their respective Board were to be subject to suspension, it would seem appropriate to amend Article XII, Section 3(j) to give any suspended member such a right to send such a representative to the Executive Board or to the Board of Governors in the circumstances set out in that provision.

3/ This could lead to nonuniform treatment of elected Executive Directors and appointed Executive Directors. For instance, an Executive Director who had been elected by only one member would cease to be an Executive Director and the member that had elected him would have no Executive Director at all during the suspension; in contrast, an Executive Director appointed by one member would retain the status of an Executive Director during the period of the suspension (albeit with some rights suspended).

have to wait until the next regular election to participate in an election? Neither approach would be without disadvantages. On the one hand, a new election upon termination of the suspension could obviously prove disruptive both for the Fund and for the other members of the constituency. On the other hand, making the member wait until the next regular election would undermine the temporary character of the suspension, as the effects of the suspension would persist beyond its termination. This might, in some circumstances, reduce the incentive for a suspended member to take the steps that would permit an early termination of the suspension. In addition, if the member were forced to wait until the next regular election, suspended members that elect Executive Directors would be treated more harshly than suspended members that appoint Executive Directors, in that, upon termination of the suspension, the former would have to wait until the next election, whereas the latter would appear to be able to have the appointed Executive Director resume all of his functions immediately upon termination of the suspension.

(iii) Other rights

It would also have to be considered whether yet other rights of Governors and Executive Directors for suspended members should be included within the scope of the suspension, such as the right of the Executive Director to communicate with the member or travel to the territory of the member at the Fund's expense, or the right of the Governor to attend annual meetings of the Fund at the Fund's expense. The extent to which the suspension of such rights would require further specific amendments of the Articles would need to be examined, in that such benefits stem from provisions of the By-Laws and the Rules and Regulations, which could be amended apart from amendment of the Articles.

2. Relationship between suspension, ineligibilty and compulsory withdrawal

Under Article XXVI, Section 2(b), a member must first have been declared ineligible to use the general resources of the Fund before it may be compelled by the Fund to withdraw. Suspension could be established as an additional measure between ineligibility and compulsory withdrawal. Accordingly, a decision of suspension could be taken at the same time as the declaration of ineligibility, or at any time thereafter prior to withdrawal of the member.

Suspension could be made a required step before compulsory withdrawal. Alternatively, it could be established as an additional power of the Fund that the Fund could exercise, but would not be required to exercise, before compelling the member to withdraw. To make it a required step before compulsory withdrawal would introduce a new constraint on the exercise by the Fund of its existing power to decide on compulsory withdrawal. The Fund's power would, therefore, be greater if it were able to decide, as a matter of

policy, whether, in the particular circumstances of the case, the member should be suspended before it is compelled to withdraw.

3. Conditions for suspension

Under the Articles, the Fund may declare a member ineligible if the member fails to fulfill any of its obligations under the Articles (Article XXVI, Section 2(a)), 1/ and may subsequently 2/ compel the member to withdraw if the member persists in its failure to fulfill any such obligation (Article XXVI, Section 2(b)). If it is to be established as an additional measure between ineligibility and compulsory withdrawal, suspension should be subject to the same basic condition as ineligibility and compulsory withdrawal, namely, the failure of the member to fulfill any obligation under the Articles (except for obligations with respect to SDRs).

Considering the importance of the measure, additional conditions might be considered, such as a finding by the Fund of exceptional circumstances or of a failure by the member to cooperate with the Fund. If such additional conditions for suspension were incorporated in the Articles, however, more conditions would be required in the Articles for suspension than for compulsory withdrawal. In addition, conditions such as exceptional circumstances and failure to cooperate might be difficult to interpret. It might be preferable, therefore, for such additional conditions to be established as criteria in the exercise by the Fund of its power under the provision. These criteria could be specifically referred to, and elaborated upon, in the Report of the Executive Board to the Board of Governors on the proposed amendment.

4. Majority and decision-making organ

If an amendment on suspension were to be adopted, it would have to be decided which organ of the Fund would have the authority to impose the suspension and what majority would be required. Ineligibility is declared by the Executive Board by a simple majority of the votes cast. Compulsory withdrawal is decided upon by the Board of Governors by a majority of the Governors having 85 percent of the total voting power. Under the Articles, some other decisions of particular significance for the Fund or its members are taken by the Executive Board by a 70 percent majority of the total voting power.

5. Procedure for amendment

The procedure on amendment of the Articles is set out in Article XXVIII(a). An amendment of the Articles must first be approved

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1/ Other than an obligation with respect to SDRs (Article XXIII, Section 2(f)).

2/ After a reasonable period following the declaration of ineligibility (Article XXVI, Section 2(b)).

by the Board of Governors (by a simple majority of the votes cast) and then accepted by three-fifths of the members having an 85 percent majority of the votes cast. 1/

For both the First and the Second Amendments, a two-step procedure was followed, in that the Executive Board first sought a resolution from the Board of Governors instructing it to prepare a proposed amendment, before it submitted the proposed amendment to the Board of Governors for approval. It would, however, be permissible under the Articles for the Executive Board to propose an amendment directly to the Board of Governors.

1/ An amendment may be proposed to the Board of Governors by a member, by a Governor, or by the Executive Board.