INTERNATIONAL MONETARY FUND

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10:00 a.m., July 5, 1989

M. Camdessus, Chairman
R. D. Erb, Deputy Managing Director

Executive Directors	Alternate Executive Directors
F. Cassell	C. Enoch
Dai Q.	
	C. S. Warner
	J. Prader
	L. B. Monyake
E. A. Evans	
E. V. Feldman	
	M. A. Fernández-Ordóñez
R. Filosa	
M. Finaish	
M. Fogelholm	
	O. Kabbaj
G. Grosche	
J. E. Ismael	
B. Jalan	
A. Kafka	L. M. Piantini
M. Massé	
Mawakani Samba	C. V. Santos
	I. A. Al-Assaf
H. Ploix	
G. A. Posthumus	
K. Yamazaki	S. Yoshikuni

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

Also Present

African Department: M. Touré, Counsellor and Director. Exchange and Trade Relations Department: L. A. Whittome, Counsellor and Director; R. A. Feldman, G. R. Kincaid. External Relations Department: S. W. Kane. Legal Department: F. Gianviti, General Counsel; W. E. Holder, Deputy General Counsel; R. H. Munzberg, Deputy General Counsel; P. L. Francotte, J. W. Head, A. O. Liuksila. Middle Eastern Department: J. Hicklin. Treasurer's Department: D. Williams, Deputy Treasurer; M. P. Blackwell, J. E. Blalock, S. Fennell, D. Gupta, D. Ross, G. Wittich. Western Hemisphere Department: S. T. Beza, Counsellor and Director. Office of the Managing Director: A. K. Sengupta, Special Advisor to the Managing Director; P. Shome. Personal Assistant to the Managing Director: H. G. O. Simpson. Advisors to Executive Directors: N. Adachi, M. B. Chatah, W. N. Engert, M. Eran, P. Gorjestani, S. M. Hassan, J. M. Jones, J.-L. Menda, P. O. Montórfano, A. Napky, P. Péterfalvy, F. A. Quirós, A. Raza, S. P. Shrestha, R. Wenzel. Assistants to Executive Directors: S. Appetiti, G. Bindley-Taylor, B. A. Christiansen, Di W., A. Y. El Mahdi, S. K. Fayyad, M. A. Hammoudi, M. E. F. Jones, C. Y. Legg, R. Marino, J. K. Orleans-Lindsay, A. Rieffel, J.-P. Schoder.

1. OVERDUE FINANCIAL OBLIGATIONS - CENSURE OR DECLARATION OF NONCOOPERATION - LEGAL ASPECTS; ISSUE OF SUSPENSION OF MEMBERSHIP; AND SIX-MONTHLY REPORT

The Executive Directors considered a staff paper on the legal aspects of censure or declaration of noncooperation (EBS/89/128, 6/26/89), a staff paper on the issue of suspension of membership (SM/89/127, 6/28/89), and the six-monthly report on overdue financial obligations to the Fund (EBS/89/133, 6/29/89).

The Chairman remarked that the purpose underlying the papers before the Board was to provide the Fund with the instruments that it needed to carry out successfully the collaborative approach to the problem of overdue financial obligations. Obviously, by their nature, the papers under discussion looked more to remedial measures than to concrete measures of support, although the two sets of measures were strongly linked. Inevitably, however, stronger remedies, with a view to providing a deterrent to arrears, would make the positive aspects of support more credible and effective. There should be no misunderstanding or misinterpretation on that score.

Mr. Yamazaki made the following statement:

Before addressing the specific issues raised by the staff, I would like to make some general remarks on the remedial measures. The Interim Committee has said that all three elements of the cooperative approach would need to be implemented forthrightly. In this connection, I would like to emphasize that a case-by-case approach would be the key to the effectiveness of remedial measures, since their ultimate objective is not to punish the countries in arrears to the Fund but to convince them to reverse the unfortunate course which they have been following. When considering remedial measures, due and full attention should be paid to the particular situations of the member countries in arrears to the Fund. I believe that any approach that ignores the particular situation of each member country would only lead to confrontation with the Fund.

With these general remarks, let me make some preliminary comments, beginning with the staff's paper on the declaration of noncooperation. Since I am in basic agreement with the staff proposal, I have only a few points to make. First, as I stated at the outset, a case-by-case approach should be emphasized when considering a declaration of noncooperation. The particular situation of a member country in arrears to the Fund should be fully reflected in the declaration.

Second, I would like to emphasize the need for flexibility. In order to safeguard the case-by-case approach, it would be essential to retain the flexibility that the Board now has with regard to declarations of ineligibility. Therefore, while I

fully support Mr. Dallara's proposal to define censure as a step between "ineligibility and compulsory withdrawal," I do not see much merit in rigidly linking the declaration with compulsory withdrawal. I think that flexibility would also be necessary in the timing of the declaration. Needless to say, there must at the same time be uniformity of treatment with regard to the conditions for issuing the declaration, where I support the staff's view. In a similar vein, I would agree with the staff on the organ to adopt the declaration. The Executive Board would be in a better position than the Board of Governors to exercise flexibility. In addition, I would be concerned that undue political pressure might be created should the Board of Governors adopt the declaration. However, I do not have strong views on this issue at this time.

Third, I am a bit hesitant to publicize the declaration. However, I am ready to follow the majority on this issue.

Moving on to the issue of suspension of membership, since I am in full agreement with the staff on the interpretation of the Articles of Agreement, I do not have much to add to the staff paper. I think that the issue of a possible amendment merits further and thorough exploration, considering the importance of any amendment of the Articles of Agreement. In any case, it would be essential for the Board to reach a consensus before proceeding toward an amendment.

Turning to the six-monthly report on overdue financial obligations, but before taking up the specific issues raised in the staff paper, I would like to reiterate my authorities' serious concern over the accumulation of overdue financial obligations to the Fund. Overdue obligations have now reached 11.3 percent of the Fund's outstanding credits. It goes without saying that the diminution of subscribed resources stemming from arrears to the Fund is a source of concern. Moreover, this chair has been worried that the rapid increase in arrears to the Fund might lead to the danger of undermining the Fund's credibility. A weakened financial position of the Fund might pose serious questions in the international financial community about the reliability of the Fund's conditionality and could jeopardize its catalytic role.

Having said this, I hasten to add that we welcome the positive developments that have occurred since the last review. However, since there is no panacea for the problem of arrears, I should emphasize that even greater efforts are needed.

With these basic thoughts in mind, this chair has supported your proposal to communicate with Fund Governors and heads of international financial institutions as a preventive measure. Thus, I have no major difficulties with the proposal presented

in the staff paper. Nonetheless, since the staff paper seeks the Executive Directors' views on this issue, I would like to offer some of my own thoughts, even though they are preliminary.

As to the substance of the communications, the proposed draft letter of the Managing Director is acceptable to me. However, I would like to emphasize the need for an appropriate case-by-case approach. The particular situations of members in arrears to the Fund would vary from country to country; such differences should be appropriately reflected in the Managing Director's communications to Governors and international financial institutions. At the same time, in order to avoid creating undue political pressure on the Fund, bilateral creditors should assume the ultimate responsibility for responding to the Managing Director's communication.

As to the potential addressees for the communications, here I would also like to emphasize the need for a case-by-case approach and appropriate flexibility. In order to make the communications effective, they should be sent to all the appropriate bilateral creditors and international financial institutions. I am concerned that the criteria suggested by the staff for addressing communications to multilateral and bilateral creditors that individually account for more than 3 percent of the overdue member's total debt might impede fair responsibility sharing among creditors and might not be effective. I would like the staff to propose an appropriate list of addressees case by case. Moreover, I wonder whether there would be any problem with sending a communication to the World Bank.

As to when the communication should be sent, I think that we should pick the most effective occasion, case by case, although I recognize the need for a rule of thumb.

Before concluding, let me touch upon the use of the collaborative approach for members that have not been declared ineligible to use the Fund's general resources. I tend to think that those countries that have recently fallen into arrears to the Fund would be able to settle their arrears by decisive self-help efforts, with assistance from the staff, since the total amount of arrears remains relatively small. In view of the risk of moral hazard, at this stage I believe that countries in protracted arrears to the Fund should take advantage of the intensified collaborative approach and that the member countries that started recently to accumulate arrears to the Fund should quickly adopt decisive and comprehensive adjustment programs to enable them to settle those arrears.

Finally, on the special charges, I have no difficulty with the staff's views. However, I would like to reserve my final decision until the formal Board meeting.

Mr. Enoch made the following statement:

As this is an informal discussion, the views I express today are necessarily tentative. Nevertheless, the Board has already given considerable attention to this important topic, and a number of the issues which it has been asked to consider have been addressed before, so I hope that it will be possible soon to reach decisions on how to move forward. The three succinct papers prepared by the staff for today's meeting should be of considerable assistance to the Board's discussions.

The six-monthly report on overdue obligations tells the depressingly familiar story of further deterioration since the last review. Charts 1, 2, and 4 show how the scale of the arrears problem has increased, while Chart 3, when considered against the others, highlights how the problem is concentrated on a few members whose arrears have continued to grow. There are some bright spots; these include the clearance of Zaïre's overdues, the success of the support group for Guyana, and the prospects of a support group for Somalia, whose Fund-monitored program will be discussed later today. But the effort involved in moving toward normalization of these countries' relations with the Fund serves to underline the need for an effective arrears strategy.

The best strategy of all would be one that ensured that arrears did not arise. The only fully guaranteed method would be to refrain from providing financial assistance, but the next best thing is to avoid exposing Fund resources to unnecessary risk. In this connection, I am glad that recent staff papers on Fund-supported programs have looked at a member's ability to repay the Fund, and at its past track record as an indicator of the member's willingness to repay.

The other element in an effective arrears policy comprises remedial measures against those countries which move into arrears, and especially those whose arrears become protracted. Today the Board is primarily concerned with those members who fail to cooperate in efforts to resolve their difficulties, which requires being able to make a distinction between a lack of ability and a lack of willingness to pay; over recent months considerable progress has been made in making such an assessment, as shown, for instance, by the various tables provided in the staff paper on the review of Somalia's overdue financial obligations, also for discussion later today.

The staff papers provide a useful summary of measures already being taken. In addition to the declaration of ineligibility, details of long-term arrears are published, by country, in the Annual Report, and the Fund has tightened the use of technical assistance for members in arrears. These measures are

appropriate. I can also reaffirm our support not to allow quota increases to be taken up by overdue members until they have cleared their arrears, and to set a deadline by which such clearance must have taken place for them to be able to participate in the current quota review.

The principal formal measures at present available to the Fund in the face of arrears comprise the declaration of ineligibility and the ultimate sanction, the requirement for withdrawal of a member. The staff papers largely focus on intermediate steps between these two measures, so that the Fund can have an additional effective measure beyond ineligibility but short of withdrawal. These steps include writing to selected Governors and other financial institutions, declarations of censure, and suspending a member.

Regarding the first of these measures, the staff paper is perhaps a little confusing. The reference to writing to Governors is introduced, in line with the Board's earlier discussion on this topic, as a preventive measure, to be used before the situation of ineligibility has been reached. As in the past, I would in principle support such communication, although the Board really needs to consider carefully what it aims to achieve in such a communication. I would echo the point made by Mr. Goos in March that the Fund must be careful not to involve the Governors too early and not to treat technical arrears, which in most cases are quickly resolved, as protracted. But the remainder of the discussion in the staff paper on writing to Governors, including Attachment III to the staff paper on overdue obligations, refers to a rather different letter, one to be written a "reasonable" time after ineligibility has occurred. Overall, I could go along with the proposal to send such a letter, but with a number of caveats. The first is that for countries not now in arrears, presumably this will be the second letter the Governors will receive from the Fund on the member concerned, if the original proposal to send a preineligibility letter is maintained. If so, one really would wish to see drafts of the two letters together, to assess their cumulative effect.

My second caveat concerns the addressees of such a communication. I would be wary of the highly judgmental approach to addressees suggested in the staff paper. I would have thought that all members should receive the communication; if not, the Board should prescribe objective general criteria which can be applied in individual cases--for instance, all members who are creditors for at least 1 percent of the official debt of the country in arrears or who are donors for at least 1 percent of the country's aid. Handling other multilateral institutions may well be more tricky. I note that the staff paper states that the Fund and Bank are working closely together in this field, so

that no communication with the Bank would be necessary. It is, of course, essential that the Fund and Bank be in line on this subject, and I would be interested in hearing whether any positive role for the Bank is envisaged. Finally, if judgment has to be exercised on the list of addressees, I would have thought that this could be largely a management prerogative. I do not think it appropriate for the Board to become regularly involved in detailed discussions of address lists. It is not difficult to imagine the time that might be spent trying to fine tune the address list for each specific case.

Two further intermediate steps are presented for the Board's consideration. Regarding suspension of membership, the staff paper concludes that this step cannot be implemented without an amendment to the Articles. This conclusion seems sound. It would therefore not be useful to pursue this option any further at present. Apart from removing the voting power of a member in arrears, the objective of suspension would be to effect public censure. But this latter objective can also be achieved through the alternative means of a declaration of noncooperation. The Legal Department's paper on this subject sets out some proposals under which such a declaration can be introduced, and makes the case that declarations of noncooperation can be published. Again, these proposals all seem sound, and I can go along with them.

A declaration of noncooperation could come, say, at the second review after ineligibility. This would allow the required reasonable time under Article XXVI, Section 2(b) for an ineligible member to attempt to remedy its position. The questions then raised include how such a declaration would relate to the proposed letter to Governors. One possibility would be to send the letter to Governors at the time of declaration of noncooperation. This has the advantage that the letter can contain substantive information for the Governors, and would in effect amalgamate the staff's two proposed intermediate steps into a single one. A simultaneous declaration of noncooperation and letters to Governors would be mutually reinforcing as a credible new remedial measure for a member ineligible to use Fund resources. The alternative is that the letter to the Governors could come earlier, perhaps at the time of the first review, warning of the prospect of the declaration of noncooperation, and seeking assistance in ensuring that the member avoid it. But in any case, the Board needs to retain flexibility in the timing of its actions. Otherwise, actions taken on a predetermined timetable may occur at inappropriate moments, and perhaps even be counterproductive in their effects.

The form of the declaration of noncooperation proposed by the staff would seem to be broadly appropriate, except for the reference to a timetable for compulsory withdrawal. I agree

strongly with Mr. Yamazaki that it would be unhelpful to reduce flexibility for the use of this ultimate sanction; a reference to the intent of the Board to recommend such action to the Governors, if evidence of cooperation is not forthcoming, is all that is required.

The staff paper on the six-monthly review of overdue financial obligations also proposes a decision regarding special charges, which seems to be on the right lines. Although special charges have not yet contributed significantly to reducing the costs the Fund has incurred because of arrears, they will do so if and when each arrears case is resolved. And although it is not conclusive, there is some evidence that special charges have had a role to play in making members more aware of the need to make timely payments to the Fund. In this connection, I noted that the special charges levied on overdue payments to the Trust Account still leave such overdue borrowing substantially concessional, and therefore may of themselves well not provide much incentive for timely repayments. I would welcome staff comments. The concept of penalty charges over and above the special charges has considerable attraction, but in reality could just enlarge and prolong arrears, and ultimately increase the burden borne by participants in support groups.

Finally, I agree with the staff that the collaborative approach should generally not be available for members in arrears but not declared ineligible. Such members--and indeed possibly some members already declared ineligible--should generally be able to concentrate on resolving their problems through their own resources, or through other sources, such as with the help of commercial banks.

I look forward to next week's formal Board discussion on this subject, and hope that agreement can then quickly be reached on the issues before us.

Mr. Monyake made the following statement:

Although this is an informal meeting, it is an opportunity that must be taken to express the importance that my constituency attaches to the issues of censure and suspension of membership in connection with overdue obligations to the Fund.

We have long maintained that the problem of protracted overdue obligations for the countries in my constituency is a part of the general debt crisis facing these countries. There has never been any deliberate action on the part of any of these countries to withhold payments to the Fund, and, even after having been declared ineligible to use the resources of the

Fund, they still consider it a priority to honor their obligations. Put simply, the problem all along has been an inability to pay. It is evident, therefore, that any strategy to deal with the problem of protracted arrears to the Fund must acknowledge this reality.

The strain of the debt overhang facing countries with arrears to the Fund in my constituency is not unlike that experienced by many other countries that are heavily indebted to other institutions, such as commercial banks; therefore, the rationale for debt reduction, which is the centerpiece of the Brady initiative, is equally applicable to them. They are all low-income countries with a significant portion of their debt owed to the Fund. Any meaningful debt relief strategy cannot ignore this aspect of their debt.

It seems to me that the question that the Board should be concerned with is an assessment of the intensified collaborative approach, to enhance its impact on the debt overhang of countries with protracted arrears to the Fund. The experience so far--and this is the time to speak frankly--is that, when it comes to the mobilization of finances, which is the key to the success of this collaborative endeavor, there is much talk but little action, even for those countries that are prepared to adopt programs to be supervised by the Fund. The fervor with which some countries call for the adoption of "strong, comprehensive programs" is not matched by their willingness to provide the requisite financing for such programs.

This being said, it will come as no surprise that we feel strongly that the Fund is moving too fast on taking punitive action, and not spending enough time on how the collaborative initiative could become more productive. Taking punitive measures against weak members is the simplest thing to do. But I would like to know how it contributes to the basic interest of the Fund, and to the resolution of the problem.

Concerning the paper on noncooperation, we have serious reservations about the second and third criteria being suggested as tests of noncooperation. The second test says that a member is not cooperating if it has paid other creditors while continuing to be in arrears to the Fund. The staff concludes that this is evidence that the member did not give the highest priority to the discharge of its obligations to the Fund and did not respect the Fund's preferred creditor status. Again, I must be candid and say that one could reach this conclusion only by taking the position that payments to the Fund--and I am not minimizing the importance of such payments--must take precedence in all cases over every other interest that a sovereign nation might have.

Nations might make certain financing decisions which might not be approved by others but which they determine to be a matter of national survival. This is indeed a factor which has forced some countries to pay certain creditors as opposed to the Fund. As for the issue of adopting programs that would improve capacity to repay the Fund, it is questionable whether one could characterize any adjustment program as such with much certainty. One might infer from the third test that countries in arrears to the Fund have this problem just because they did not implement a Fund program. Certainly, this is hardly the case. It is true that economic adjustment must be implemented with the full commitment of the authorities, but the matter must be kept in the proper perspective.

This brings me to the issue of the cooperative approach of the Fund. It seems to us that cooperation in regard to solving the arrears problem is seen as a one-way street--pay or perish. At a time when the Fund is taking the lead in asking commercial banks to be lenient with debtors to reduce the debt overhang and is even committing its own resources to help those debtors, it is difficult to explain why it is taking such a hard line against certain of its members.

Regarding the issue of suspension of membership, we support the view that the Fund has no legal right to suspend a member's right over and above what is prescribed in the Articles, and we do not believe that the Board should pursue the matter further by recommending an amendment to the Articles.

Our understanding of Article XII, Section 8 is that there is no legal basis for the publication of a declaration of non-cooperation. Our interpretation is that a decision to publish such reports can be made only if the economic policies of a member directly tend to produce a serious disequilibrium in the international balance of payments of members, and with a requirement for a 70 percent majority. All other expressions of the Fund's views must be communicated informally--indeed, perhaps we need to reconsider the legality of publishing decisions on ineligibility. Besides, we do not see how publishing a report on noncooperation contributes to helping the Fund carry out its purposes.

The Chairman said that he was concerned about the thrust of Mr. Monyake's remarks on three grounds. First, if Mr. Monyake continued to take the same approach, it would stand in the way of an effective, cooperative solution. Moreover, his approach overlooked several factual elements, including the effective action--not just words--being taken with respect to the establishment of support groups. Certainly, the President of Guyana had informed the Fund that he took a different view of what both the Fund and the World Bank had done for Guyana.

Second, on the issue of unwillingness versus inability to pay the Fund, it was possible that the countries currently in arrears, and especially those in protracted arrears, were unable to pay the Fund at the present stage, the Chairman said, and that fact had to be taken into consideration. But a closer examination of the facts revealed that in some instances, failure to pay had its origins in unwillingness. Because that unwillingness frequently went hand in hand with poor policies, it rapidly led to inability. What the Fund had to do was to establish the conditions for avoiding instances of unwillingness in the future, and those conditions of course necessitated well-designed programs and effective instruments with which to support them. It must not be forgotten that the Fund had created those instruments, in the facilities it had established for the purpose and that benefited in particular the poorest countries, especially in Africa. The enhanced structural adjustment facility, for instance, could make a significant contribution to the implementation of sound programs supported by financial resources.

Third, remedial actions were a necessary element of the picture because the Fund, to be credible, had to protect its preferred creditor status, the Chairman added. Describing such remedial measures as punitive undermined the very purpose of strengthening the remedial measures with a view to convincing countries of the need to embark on a sound, cooperative strategy that would help the Fund help them to overcome their difficulties.

The staff and management should at least be given the benefit of the doubt with respect to their sincerity in adapting the Fund's facilities to meet the reality of member countries' situations, the Chairman remarked. And the Fund needed all Executive Directors to contribute to the design of the instruments available to it for providing stronger support to countries in difficulties.

Mr. Monyake responded that he did not question the sincerity of the Fund or the countries that had been called upon to coordinate support groups, who were doing their best. His point was that the response to the efforts to implement the intensified collaborative approach had not been as good as might have been expected. He agreed that inability to pay the Fund might well have root causes that had to be corrected. In that connection, he reiterated his belief that personal knowledge of the countries in difficulties, based on visits by Executive Directors, would lead to a clear understanding of their problems.

The Chairman remarked that the staff and management visited all member countries, in a desperate effort to convince them to cooperate while they still had time.

Mr. Posthumus said that he too had been disappointed by the tone of Mr. Monyake's statement. He also wished to take issue with what seemed to be his identification of the problem of arrears with the problem of development. There were many countries in the same situation as those with arrears to the Fund that did repay the Fund and that treated the Fund

as a preferred creditor. Furthermore, it was surely in the interest of the smaller countries in the world to defend the integrity of the Fund. The institution should not tolerate unwillingness to pay on the part of members, and there were some who had been unwilling from the outset and who remained unwilling to make even small payments. The issue before the Board was how to deal with that problem. While it was difficult to identify countries that were unwilling, it was patently untrue to identify such countries as developing countries.

Mr. Kafka noted that as his chair had indicated in previous meetings, his constituency did not favor the introduction of the instrument of censure or declaration of noncooperation. On the contrary, there was a strong feeling that at the present time, the Fund should continue to pursue its so-called collaborative strategy, which it had only very recently initiated. A renewed effort should first be undertaken to make that strategy a success, relying on the example of those countries that were benefiting from it to induce all those countries still in arrears to join the strategy. Despite the enormous efforts of Mr. Massé, the Special Advisor to the Managing Director, and the staff, not enough resources had been collected for Guyana as it would have liked or could in fact be considered adequate. It was exceptionally commendable that Guyana had, nevertheless, decided to go ahead with the very radical reforms that formed part of their program. The introduction of an additional, purely punitive measure into the Fund's arsenal of instruments for dealing with arrears could only discourage cooperation.

He had also been impressed by the fact that censure or declaration of noncooperation would have no legal effect, Mr. Kafka stated. Moreover, he was not convinced that such a declaration could be adopted by a simple majority of the Board.

With respect to the suspension of membership, his chair entirely agreed with the staff's conclusions, Mr. Kafka said. Moreover, it was inadvisable to initiate the process that would lead to an amendment of the Articles in order to permit the suspension of membership. His chair was motivated by the same reasons for which it considered inadvisable the creation of the instrument of censure or declaration of noncooperation.

As previously stated, Mr. Kafka concluded, his chair did not favor sending a communication from the Managing Director to all or some Governors on a country's nonperformance. However, for reasons that had already been given, his constituency could support a communication, to be sent by each Executive Director to his Governor or Governors, at the request of the Executive Board.

Mrs. Ploix made the following statement:

> I share most of the staff's views on the recent development of arrears. The significant increase observed during the period under review indicates both the lack of progress made by the countries with the largest protracted arrears, and the fact that

the number of countries falling into arrears to the Fund remains stagnant. There is no "contagious effect," and this problem, although of the greatest concern, continues to involve only a limited number of countries. Furthermore, as stressed by the staff, varying degrees of progress have been registered during the period under review. Indeed, one country with a very large outstanding purchase was able to settle its arrears while other countries are at different stages in implementing the cooperative approach. These recent developments are encouraging, even though they are not translated into the figures that are provided; they show that the cooperative approach is working relatively well and can only induce all of us to make our best efforts to ensure that this strategy is successful.

Concerning the possibility of applying the cooperative approach to members that have not been declared ineligible, I agree with the line of reasoning put forward in the staff report. In fact, the cooperative approach is intended to help solve the most difficult cases in which the application of regular procedures has proved unsuccessful. Applying this approach to countries that have recently encountered difficulties in remaining current with the Fund would amount to standardizing this procedure. For these countries, the implementation of adjustment policies combined with additional financial support under the standard procedures, if required, seems more suitable.

Lastly, I can go along with the decision on special charges.

I would like to turn now to the remedial actions proposed for discussion, making first some general comments, which will also be tentative and preliminary.

We believe that we must not rule out remedial measures, a priori, although in point of fact, the mere economic and financial consequences of being in arrears should serve in themselves as a deterrent to countries from falling into arrears. By focusing excessively on remedial actions, we could weaken this line of reasoning, which we should continue to assert. These actions should not be seen as punitive but as a means of encouraging members to settle their arrears or to remain current vis-à-vis the Fund. Before implementing them we should carefully assess their potential effectiveness. Otherwise, we run the risk of such measures being counterproductive or showing that the Fund is incapable of settling this problem, thereby endangering its credibility.

On the specific proposals before us today, I am open to communicating with certain Governors and heads of international financial institutions about countries in protracted arrears.

Such an action is consistent with the collaborative approach and could be useful in certain cases. In order to be efficient, this approach should not be applied in a general way; it should be applied on a case-by-case basis. A judgmental approach is essential in order to avoid making this procedure routine and thereby pointless. Of course, such an approach should nonetheless comply with the principle of equality of treatment. Consequently, I believe that the content of the letter should also take into account the specific circumstances of the case involved. Similar caution should be exercised with the list of potential addressees who should be free to decide upon the measures they want to adopt. In our opinion, the number of addressees should be limited. Lastly, this approach should not be seen as a kind of campaign against the country concerned.

On possible forms of censure or declaration of noncooperation, I still need to be convinced. I see two main problems in this regard. First, in expressing our intention to recommend compulsory withdrawal or, even more, in deciding to require the member to withdraw, we run the risk of having our hands tied. Let us assume that, following the declaration, the overall context of the country concerned changes; what shall we do if the member is still in arrears to the Fund? It would probably be counterproductive and even unfair to initiate the procedure of withdrawal; at the same time, if we do not follow it up, we could be seen as irresolute.

Second, this procedure raises the question of the appropriateness of compulsory withdrawal. As you know, this chair does not think that we should go so far, since this would be a decision fraught with far-reaching consequences. In any case, before deciding on a possible declaration of noncooperation, it would appear quite logical to have further discussions on the advisability of compulsory withdrawal in itself.

As regards publication, we wonder whether it would not be counterproductive or risky to demonstrate the Fund's inability to cope with the arrears problem.

Finally, I would like some clarification on how this approach, if adopted, would be applied. Could we be assured that the votes cast would be published in detail in the report and that a very high voting majority would be required? Such a critical decision needs as large a consensus as possible, and although they do not favor censure, if it is adopted, my authorities would request these conditions.

On the issue of suspension of membership, let me first stress that I found the staff paper very interesting and quite clear, in spite of the complexity of the matter. In our view, the paper makes it clear that the Fund could not use an implied

power of suspension of membership for failure of a member to meet its financial obligations to the Fund. Furthermore, it appears that the Fund has never resorted to the doctrine of implied power for imposing exclusionary sanctions. Therefore, an amendment of the Articles would be required. According to the staff, this amendment would only introduce an additional form of suspension, limited to voting rights attached to membership. One might question whether such a suspension would readily dissuade countries having already been declared ineligible to use Fund resources. Furthermore, it would not be of any tangible benefit to the rest of the membership. Finally, such a procedure is complicated and may not be successful. Therefore, we wonder whether it is worthwhile pursuing this path.

Mr. Filosa made the following statement:

The staff has offered extensive and clear documentation on the different aspects of the development of overdue financial obligations to the Fund and on the circumstances in which, in the different countries, arrears to the Fund have emerged. Such documentation speaks for itself, but two aspects of the present situation of arrears are worth recalling. First, arrears have risen in the last several months at an annual rate of around 55 percent; and second, more than 70 percent of total arrears have been outstanding for longer than one year. This rapid increase of arrears and the parallel surge of their average duration underscores once again the need to implement a consistent and differentiated set of remedial measures aimed at showing very clearly that noncooperation with the Fund implies rising costs and declining benefits for the countries themselves.

It goes without saying that, in enlarging both the set and the scope of remedial actions, we are aiming to bring back in the mainstream of international cooperation those countries that have incorrectly chosen not to participate in the joint effort made by other members of the Fund.

Today we are discussing the possibility of direct intervention by the Governors of the Fund in this effort. I will offer my personal preliminary remarks on this matter, which is presently under review by my authorities. First, I believe that direct intervention by Fund Governors is appropriate, in particular because it is well understood that such a measure is mainly aimed at avoiding the need for further remedial actions. Second, I believe that an effort on the part of the Governors should be limited to those exceptional cases in which the ongoing efforts of the Executive Board and the management may need to be supplemented. Such an instance would arise when we can unambiguously prove a discriminatory attitude toward the

Fund. Third, the communication to the Governors should be part of a well-identified set of measures of increasing stringency, not the last step. This would be necessary in order to avoid undermining the credibility of the Fund, and of the Governors, in those cases--and hopefully there will be none--in which, after intervention by the Governors, a noncooperating member continues to accumulate arrears and discriminate against the Fund. Therefore, before taking a decision on the question of the communication to the Governors, we have to complete our review of the matter and decide on the nature and the scope of the additional remedial actions. The declaration of noncooperation seems to me to be a possible first step after the communication.

I come now to the specific questions raised in the paper. On the question of the addressees, I do not believe that such a communication should be sent to all Governors. It should instead be sent only to major creditors of the country in arrears. On this point, the staff could, perhaps, clarify its proposal to send the communication to creditors--bilateral and multilateral--that individually account for more than 3 percent of the total debt of the member. Specifically, what does this proposal imply, in each case, in terms of the number of communications to be sent, and what share of the total debt of the country in arrears is held in the aggregate by creditors having individually more than 3 percent of the outstanding debt? One possibility to explore could be the number of creditors involved, and the share of the debt at different threshold levels, for example, 3, 5, or 10 percent. In choosing the threshold, the number of addressees should be limited provided that the creditors represent a substantial share of the total debt (for example, 50-60 percent of the total).

Regarding the proposal to send this kind of communication to other international financial institutions, I believe it is worth bearing in mind that, since the objectives of these institutions are, at least in part, different from those of the Fund, it might be difficult to get their support for such a concerted effort. It is also probable that such support would necessitate some reciprocity, which it is not advisable for the Fund to incur.

As to the question of the occasion on which such communications should be sent, it seems to me that, as a general rule, we should send the communication when two specific conditions arise: when, after having declared the member ineligible, we have firmly reached the conclusion that the member is unwilling to cooperate; and when we have already decided that technical assistance to the member in arrears is inappropriate. Consideration should also be given to whether the member is on the verge

of substantially further increasing its arrears to the Fund because of the possible existence of a particular concentration of previous purchases of Fund resources.

On the substance of the communication, I am in broad agreement with the proposed language. In addition, it seems to me that it would be appropriate to complement the communication with a separate paper which would include the main features of recent developments in the country with respect to overdue obligations. This paper should feature a relatively short description, along the lines followed in Attachment III to the staff paper, of the recent developments in the relationship between the member and the Fund. This paper might also include a concise but comprehensive statistical appendix showing, inter alia, the level of the arrears to the Fund as well as to other bilateral and multilateral creditors, the length of time for which these arrears have been outstanding, and the payments made. Such a paper and its appendix would help clarify, to the Governors and their agencies, our conclusions on the highly controversial issue of unwillingness to cooperate with the Fund.

In the case of members that have not been declared ineligible, I do not believe that we should rely on the use of the collaborative approach. The instrument of the communication to the Governors is indeed a powerful one. But at the same time there are clear institutional and political limits to its use. We cannot overburden this instrument and overstretch the flexibility of our institution.

Finally, as regards special charges, we can go along with the staff proposal in favor of retaining the present system, even though its effectiveness is rather limited.

Mr. Massé said that his authorities had noted with concern the increasing frequency with which staff papers were being circulated for consideration at short notice.

With respect to the papers under discussion, Mr. Massé continued, his authorities were not convinced that the approach on censure or declaration of noncooperation would be very effective. Moreover, to the extent that the declaration was combined with a decision or an intention to require the member to withdraw from the Fund, which would seem necessary to give the declaration any potential force, his authorities doubted whether the necessary 85 percent voting majority of the Board of Governors would be marshalled to take that ultimate step. Furthermore, that step could lead to unnecessary complications by introducing an added political dimension at the Board of Governors' level.

With respect to the issue of suspension of membership, his authorities accepted that the Fund did not have the legal authority to suspend

members, and that in order to confer such a power upon the Fund, an amendment to the Articles would be required, Mr. Massé said. However, they would be reluctant to consider amending the Articles of Agreement to obtain that authority, which would open up a Pandora's box.

With respect to the six-monthly report on overdue obligations, his authorities would support communications with a number of Fund Governors and heads of other international financial institutions, Mr. Massé commented. Such a remedial measure might have a positive effect, perhaps largely by having a sensitizing influence. They would also be prepared to support the staff's suggestions with respect to the substance of the communication, potential addressees and the appropriate occasions to send communications.

His authorities also agreed that the intensified collaborative approach would not be appropriate for members that had not yet been declared ineligible to use the Fund's general resources, Mr. Massé stated.

Finally, his authorities supported the continuation of the present system of special charges on overdue obligations, without change, as suggested by the staff.

Mr. Fogelholm, making brief, tentative remarks, considered that it was important to emphasize that the primary goal for all established procedures and actions contemplated with respect to countries in arrears to the Fund should be the elimination of the overdue obligations. The most important of such procedures was the collaborative approach, which had the full support of the Nordic countries. To the extent that that approach needed to be complemented with sanctions, such measures should be considered with a view to their effect on the possibilities for eliminating the arrears. However, in some instances, sanctions could prove necessary in order to limit the economic damage to the Fund and to signal the discontent of the membership.

He agreed with other Directors that a clear distinction needed to be made between cooperating and noncooperating members, Mr. Fogelholm added. That was, indeed, a most delicate and difficult task to undertake, but he believed that much progress had already been achieved and he looked forward to further work in that field. Of course, it was for the noncooperating countries that further sanctions could be considered, and despite the fact that experience to date with the existing procedures had not been particularly encouraging.

In sum, to the extent that sanctions were contemplated, Mr. Fogelholm observed, it was important first, that they enhance rather than weaken the incentives for the member in arrears to fulfill its obligations to the Fund; second, that they not carry an unreasonable risk of loss of credibility for the Fund in case such actions fail; and third, that they supported the collaborative approach.

On communications to member countries in arrears, his chair continued to have reservations about introducing various types of communications, Mr. Fogelholm commented. Regardless of whether such a measure was preventive or remedial, there was a clear danger that it might cause an undesirable politicization of Fund procedures. On the other hand, his constituency believed that the proposal for a declaration of noncooperation warranted further discussion.

The staff paper on the suspension of membership showed clearly that the introduction of a sanction of that nature required an amendment of the Articles, Mr. Fogelholm concluded. The possibility of such an undertaking could be kept open, but should--in the opinion of his authorities--be viewed only as a last resort. It was, however, doubtful from a procedural point of view if such an amendment was even feasible.

Mr. Mawakani recalled that during the Board's further consideration of the modalities of the cooperative approach to overdue financial obligations to the Fund (EBM/89/18 and EBM/89/19, 2/17/89), Mr. Warner had made the following statement: "Another major issue...is the suspension of membership rights. We understand that the follow-up paper that the Legal Department is preparing on this subject is likely to conclude, as did the previous paper, that there is nothing meaningful that can be done in this direction without amending the Articles. If this is the case, then we should look for other possible steps between ineligibility and compulsory withdrawal." In the introductory paragraph of the staff paper on censure or declaration of noncooperation, the reference to the suggestion by one Executive Director in particular that such a possible step between ineligibility and compulsory withdrawal be explored was no doubt to Mr. Warner's statement on behalf of the U.S. authorities. That statement indicated that six months previously, it had been evident that short of amending the Fund's Articles to provide for the suspension of membership rights, the Fund had no general power to suspend all membership or a member's rights without amendment. The staff's examination of the question whether the Fund could, in the absence of express powers, suspend such rights concluded that the Fund could not exercise an implied power to do so. He strongly supported the staff's conclusion. Although the staff had examined in its paper the possibility of amendments to the Articles, particularly with respect to the suspension of voting rights, he did not believe that the time was appropriate for the Board to proceed to consider and recommend an amendment. The Fund's Articles were sacrosanct and should not be tampered with hastily or wantonly.

On the subject of the declaration of noncooperation, the major question to be addressed was whether the Fund needed an intermediate procedure or steps in the current procedure that had been established for monitoring the situation of members that had been declared ineligible, Mr. Mawakani continued. Would such an intermediate step serve any useful purpose, or, in other words, since the Fund was not empowered to suspend membership rights, was a declaration of noncooperation the best procedure for strengthening the remedial measures where genuine cooperation did not appear to be forthcoming from a member? His chair did not think so. In

paragraph 3 of Section I of EBS/89/128 on the effects of the declaration, it was clear that the declaration of noncooperation was just another name to be attached to a member that was already in a state of ineligibility. The only effect was to tarnish the image of the member. Furthermore, a declaration of noncooperation would neither reduce any rights of membership nor impose any additional obligations on the member, in the words of the staff paper. The staff had concluded that the declaration would be essentially a form of exhortation to the ineligible member, by an organ of the Fund, to comply with its obligations. If all that was necessary was to exhort or strongly urge a noncooperating member to cooperate with the Fund, then a procedure for doing so already existed and it must be used effectively.

The advisability of continuing to use the existing procedure was clear from paragraph 1 of Section II on the timing of the declaration, Mr. Mawakani considered. The existing review procedures were adequate, including those following the declaration of ineligibility to use the Fund's resources. It would be sufficient to strengthen the content of the Managing Director's communication following a review. In that connection, the conditions for issuing the declaration, as set forth in Section I, paragraph 1 of EBS/89/128, were a broadly appropriate starting point, provided that necessary amendments were made to the criteria for determining or establishing a member's failure to cooperate with the Fund. The staff argued that the criterion or test for noncooperation of a member having made payments to other creditors while continuing to be in arrears to the Fund demonstrated that a member was not giving the highest priority to settling its obligations to the Fund but was on the contrary not respecting the Fund's preferred creditor status. That criterion posed difficulties for him, and he strongly urged that it be reconsidered or considered only on a case-by-case basis, taking into account the need of certain member countries to make payments to other creditors in order to maintain essential imports.

Mr. Prader noted that his views must be tentative at the present stage. Creditor interests were predominant in his constituency, and the issue of overdue payments to the Fund was therefore being considered with particular concern. At the same time, his chair had tended to be skeptical about the application of remedial measures because they seemed to affect the cooperative spirit of the institution. The legal formulations of the ideas put forward in the staff papers appeared convincing, but before any legal proposals were discussed with a view to their imminent adoption, their economic and political substance would also have to be assessed, as would their helpfulness in attaining the objectives of the cooperative strategy.

Any new proposal for strengthening the effectiveness of the Fund's remedial measures would have to be judged on the basis of two criteria, Mr. Prader considered. The first criterion was whether the restrictions that it would imply for the cooperative character of the Fund would be within tolerable limits; and the second was whether it would be efficient in terms of actually reducing the arrears.

The difficulty with a declaration of noncooperation was that it would increase frictions and disputes between the Fund and members, without actually improving the chances of settling members' arrears, Mr. Prader commented. The requisite assessment of a member's noncooperation would introduce a divisive element into the Fund's relations with members that had already lost the right to draw on the Fund's resources as a result of a declaration of ineligibility. In asking himself what was the comparative advantage of a declaration of noncooperation over a declaration of ineligibility, he failed to see that the concept of such a declaration was anything more than an explicit reconfirmation of a country's ineligibility to use the Fund's resources in the form of an additional procedural layer, and without any legal effect. In the view of his chair, a declaration of ineligibility would suffice as a statement of a member's noncooperation with the Fund. The addition of intermediate steps between the declaration of ineligibility and the call for compulsory withdrawal seemed unlikely in reality to increase the pressure on members to repay the Fund.

From the standpoint of demonstrating the seriousness and full force of the Fund's intentions, the suspension of membership might be the most efficient step, Mr. Prader noted. Recourse to suspension might thus be worthwhile, despite the negative impact on the perception of the Fund as a cooperative institution. However, it seemed doubtful that the Fund should amend the Articles of Agreement solely for that purpose. To do so would open a Pandora's box of requests for changes in the Articles of Agreement that were motivated by other considerations, and for the time being, his chair would be reluctant to support such a move.

In sum, the balance of costs and benefits of the proposed measures did not seem to his authorities to be sufficient rationale for adding still more instruments to the Fund's list of remedial measures, whether in the form of a declaration of noncooperation or of a suspension of membership, Mr. Prader stated. If the purpose was to bring home a clear message to members unwilling to pay, then one very efficient remedial measure already existed: countries that did not pay the Fund could have no new money from the Fund unless and until they settled their arrears.

Finally, on the issue of a communication from the Managing Director to the Governors, he took the same position as Mr. Fogelholm, Mr. Prader observed. Until the Board returned to the matter in greater detail, during its formal discussion on the staff's proposals, he wished to make only one brief comment on Mr. Filosa's proposal to send the communication only to the major creditors. The danger with such a proposal was that it would further enhance the perception that the matter of support groups was one for the G-7 or G-10 countries only.

In conclusion, Mr. Prader said that he could support the proposed decision on special charges.

The Chairman said that he wished to mention, in passing, that in encouraging the staff to propose an intermediate step between ineligibility and compulsory withdrawal, he had had in mind one of the long-standing difficulties with which the Fund was confronted in carrying out its arrears strategy--namely, the fact that the political leaders of member countries were not sufficiently aware of the meaning and consequences of arrears to the Fund. Neither the officials nor ministers of finance and central bank governors were eager to explain the situation to their leaders. He himself had recently had personal experience of discussions with a member country in protracted arrears, in an effort to try and convince it that it was in the country's interest to look more to the real meaning of cooperation with the Fund. He had discovered that the head of state had never been given an explanation of the impact of protracted arrears, under the Fund's burden sharing system, on countries poorer than his own. The special advisor to the head of state, when he had been informed of the extent of what was in effect the imposition of a tax on poorer countries as a result of other countries' arrears, had been most distressed, but it was only too clear that he too would not volunteer to pass on the information to his head of state.

That experience had revealed to him, the Chairman added, the need, in one way or another, to bring the matter of arrears to the attention of leaders. And one of the few instruments available to the Fund for that purpose was publicity. The country's arrears to the Fund had to be reported in newspapers and in the media if leaders were to be made aware of reality in that respect.

Likewise, when a country, for whatever reason, including political reasons, decided to limit its payments to the Fund as well as to other institutions and to embark willingly at the outset on the road to arrears, it was done in ignorance of the financial consequences, the Chairman observed. Countries did not realize that in general, and very soon, they would be cut off from receiving international aid, for the reason that governments themselves took an ambiguous stance, leaving the problem to the ministers of finance and the Fund to settle. In that way, countries could retain the illusion that nothing had changed and that financing would continue to flow.

If the Fund wanted to avoid arrears, it had to find ways to communicate more explicitly and at an earlier stage with those at the highest levels of government in countries with arrears, the Chairman stated. While that aspect of the procedures was less related to the question of censure than to other steps, the Fund's constant preoccupation must be to make its arrears strategy more efficient at every stage and to help countries to understand better the consequences of their actions that led to arrears. An explicit explanation to them of the consequences of their decisions not to respect the Fund's preferred creditor status--even those taken for good humanitarian or other reasons as mentioned by Mr. Monyake--would prove within a short time to be a mistake because the country's flow

of international financing would dry up sooner or later. In sum, the Fund had to be much more outspoken to be more efficient in dealing with members' arrears.

Mr. Prader asked whether the consequences to which the Chairman had referred could not be spelled out in the declaration of ineligibility.

The Chairman responded that the Board did mention, in the decisions that it took when it reviewed a member's overdue financial obligations or declared a member ineligible to use Fund resources, that arrears imposed an undue burden on the rest of the membership. But those decisions did not get into the hands of heads of state, who on the contrary, were protected from bad news. The Fund had to find a way to break through those protective barriers.

Mr. Fogelholm asked whether the draft letter to the Governor could not be sent instead to the head of state. Publicizing declarations of ineligibility did not seem to have much effect, and the problem was how to make a declaration of noncooperation any more effective from that point of view.

The Chairman noted that the Fund's normal procedure was to communicate with Governors, but the staff would keep Mr. Fogelholm's point in mind.

Mr. Jalan said that he did not regard the issue of arrears as a debtor or a creditor issue. It affected all countries, the Fund, and international cooperation. Whatever decisions the Board reached must lead to productive and positive results as well as to a strengthened institution. He also agreed with Mr. Posthumus that the issue was not one of development. Although only countries borrowing from the Fund would be affected for the time being by whatever decisions the Board took for dealing with members having overdue financial obligations, international default and the action taken to deal with it raised issues that were neither new nor confined to developing countries. The historical record showed that there had been many previous cases of international default, far more numerous than at present, and tough action had been taken in response to outcries of concern. But his reading of history was that punitive action against countries in similar situations seldom worked.

Moreover, the issues with which the Fund was dealing called for the exercise of considerable judgment, Mr. Jalan noted. As Mr. Monyake had pointed out, some countries had been unable to pay the Fund. There were also cases of countries that might have been unwilling to pay the Fund. But in any specific case, an element of judgment was inevitably involved at a particular point of time. Even if it was generally agreed that the country was unwilling to pay, it would also be a matter of judgment as to how to achieve a productive, positive, result in such a case. Given the need for judgment and the uncertainties involved, he believed that the Fund should move very cautiously in considering further action and the nature of that action.

The strong preference of his chair was to limit action by the Fund to the financial level rather than raising it to the political or diplomatic level, Mr. Jalan stated. Even if the Government of a country was following mistaken policies or was unwilling to cooperate, punitive international action against that country became action against its people, or could at least be projected as such. Therefore, solutions to the problem of overdue financial obligations had to be found that would confine it to the financial arena rather than raising it to the international--either on a bilateral or multilateral basis--or regional political arena. After all, the problem cases confronting the Fund were of a very different nature from those confronting a commercial company or an individual. All those political aspects had to be kept in view in considering what further action was necessary.

As far as suspension or withdrawal of membership was concerned, Mr. Jalan said that he had noted that several Directors shared the view that any solution along those lines should not be considered actively at the present stage because it would lead to more problems than it would solve. As for censure or a declaration of noncooperation, his judgment at present was that it would probably not be helpful and that the Fund would do better to persist with the collaborative approach and with the kind of action that the Managing Director himself had taken to establish contact with heads of government to communicate to them the serious consequences flowing from not affording the Fund a preferred creditor status. Any legal action of the type envisaged would have uncertain results as well as be subject to misinterpretation, for reasons that had been elaborated by both Mr. Prader and Mr. Kafka.

Mr. Posthumus said that even though the discussion was still at a preliminary stage, he could accept the concept of censure as a step between ineligibility and withdrawal. He had no firm opinion on the issue of suspension of membership, although if it were ever to be introduced, it would be immeasurably better than compulsory withdrawal, for which the Articles of Agreement already made provision. Withdrawal from the Fund meant the end of all relationships between the institution and the country, and he had always been reluctant to go that far. For the time being, he wished to reserve his position on the issue of suspension.

On the question of whether the Executive Board or the Board of Governors should be responsible for taking the step between ineligibility and withdrawal, Mr. Posthumus noted that there were arguments on both sides. However, it should probably be a matter for the Executive Board because long and careful preparation would be needed before such a step could be taken, and he doubted whether it would be possible to involve over 150 Fund Governors in the process.

The contents of the declaration of noncooperation on censure should not indicate any ultimate link with compulsory withdrawal or suspension, Mr. Posthumus considered. The criteria for issuing a declaration of

noncooperation, which were very general, as they should be, were acceptable to him, although he could agree with Mr. Mawakani that the capacity to pay should be part of the second criterion, and he believed that it was.

On communications to Governors, Mr. Posthumus said that it was not clear at what stage the letters would be sent, or whether they would be sent at two different stages. The exact meaning of the letter also needed to be made very explicit to the recipients. Was the purpose of the letter to provide information on the existence of overdue financial obligations, or was the intention to obtain assistance in solving the problem? As he understood it, the purpose was to seek help in solving the problem and not only to give advance warning of a serious problem. As for the addressees, he agreed with Mr. Enoch that the Board should not be responsible for the lists. However, as noted in the staff paper, the Board should ask the member governments of the Paris Club to cooperate in solving the Fund's arrears problems, particularly as the Paris Club regularly sought the cooperation of the Fund in debt rescheduling exercises.

In conclusion, Mr. Posthumus stated that as Mr. Hogeweg had already mentioned, one issue that was not discussed in the staff paper and that should be considered at a certain stage was how to deal with the financial consequences for the Fund of suspension or compulsory withdrawal. In a formal sense, there would be no consequences--the debt would not be paid and would stand in the Fund's books. But in a material sense, the Fund would practically destroy its chances of being repaid. Therefore, thought should be given to strengthening the Fund's financial position, for instance, either prior to the activation of provisions for suspension or compulsory withdrawal, or at the same time.

Mr. Dai made the following statement:

> Before commenting on the specific issues raised in the staff papers, I would like first of all to stress again a few general remarks to which we attach great importance. First, the Fund should firmly preserve its international cooperative nature by dealing with such matters in an essentially different way than commercial banks. Second, as the Fund is an intergovernmental organization, the political implications of its actions must be fully taken into account. Third, the overdue problem is a part of the debt crisis of the 1980s, a unique situation never before encountered in the history of the Fund. This background should not be neglected.
>
> Although the total amount of overdue obligations to the Fund has continued to increase, further progress has been achieved in the past six months toward a resolution of the problem. I am glad to note the positive development with respect to the implementation of the intensified collaborative approach, as summarized in the staff's six-monthly report. As

a result of the cooperative approach, one member country fully settled its overdue obligations in May, and more countries have started or are committed to make payments to reduce the stock of their overdue obligations to the Fund. The Fund-monitored program for Guyana was approved by the Board, holding out the prospect that the country will fully clear its arrears to the Fund before the end of the year. Active preparation of similar programs for some other member countries, like Somalia, is also well under way.

In brief, more significant and more positive progress has been made in the past six months than in the previous review period, providing further proof that we have been proceeding in the right direction. Looking at varying country experiences, the recent progress has apparently been achieved as a result of intensified cooperation among the member countries in arrears, their major creditors, and the entire membership of the Fund rather than as a result of punitive measures. I strongly believe that the current positive momentum should be maintained, so that we can broaden the scope of the success we have experienced and convince and encourage other members in arrears to take part in the intensified collaborative strategy.

On the specific proposals in the staff papers, first, this chair has always been skeptical about the effectiveness of remedial measures of a punitive nature as a solution to the overdue problem. Instead of restating our view, I would like to comment only briefly on the criteria by which the cooperation of a member with protracted arrears is to be judged. While the two criteria--payment performance and quality of economic policy--may be applicable in general, we may need to be very cautious in practice when applying them in individual cases. What if the interruption of payment of debt or the implementation of an economic program is due to factors which are beyond the authorities' control? For instance, how do we deal with the current political difficulties in Panama and the devastating natural calamities that struck Sudan last year? I do not think we can make proper judgments based merely on economic criteria in cases such as these.

Second, on the communication with Governors, which has been proposed as a further remedial measure rather than a preventive measure, the view of this chair has been very clear. On the one hand, we hold the constant view that the causes of some member countries' protracted arrears to the Fund are complex and deep-rooted and cannot simply be attributed to misbehavior on the part of the individual countries. Therefore, solutions to such disputes cannot rely merely on increasing pressure or sanctions, but will rather rest with patient consultations and negotiations in the spirit of cooperation and understanding.

On the other hand, the political implications of such communications to Governors must be taken into consideration. We expressed our concern and reservations to this effect during previous discussions. Because political and administrative systems and practices in member countries vary, I believe that, in addition to the criterion proposed, it would be better if the potential addressees were consulted and selected on a voluntary basis.

In conjunction with the issue of censure or declaration of noncooperation of a member, it appears to me that the proposed communication to Governors is in many ways similar to the proposed measure for censuring a member, if both measures are to be used for remedial purposes and particularly if the latter is also to be communicated to the Board of Governors for consideration, as proposed. The measures may differ on certain technical points, but as long as they serve the same purpose and have similar implications and effects, they could become essentially repetitive instruments. Furthermore, to declare a member ineligible is itself essentially an implicit declaration of noncooperation. I do not see the merits of a further, new declaration, which would clearly be nothing more than a form of exhortation of the ineligible member, as the staff itself has stated. More important, since all of us would wish these measures to be confined to extreme cases and on a limited basis, I cannot understand why we are spending so much time on similar actions. Anyhow the proposal is premature, I believe, given the fact that the current intensified collaborative approach, which is in its initial stage, has only just begun to function, so that experience with its results is still lacking.

Third, on the issue of suspension of membership, I believe the analysis in the staff paper led to a very straightforward conclusion. The Fund's Articles do not provide it with the power to suspend all membership rights of a member. The issue is thus one of the Fund's charter, and I do not believe at this stage in the necessity to consider an amendment of the Articles just for the sake of dealing with the overdues problem.

Mr. Warner made the following statement:

The Board is well aware of the importance my authorities have attached to resolving the arrears problem. Obviously, their resolve is steady, and I can confirm that their view in this critical matter for the Fund will remain unchanged. I also think that their basic concern needs to be reiterated from time to time: we view the issue of arrears as very directly related to the responsible consideration of a quota increase.

Since the beginning of this year, some important progress has been made, and I think we are beginning to deal with this problem somewhat more effectively. We are especially pleased with progress to date in the intensified collaborative approach, and I will have more to say about this momentarily. However, despite a positive turn of events, arrears continue to grow, and more countries have been added to the list of members in arrears. I think that the Board would have to agree that we have some further way to go before we can declare that we have reasonable control of this problem.

From this perspective, we welcome the opportunity to reassess our arrears strategy, and we consider the staff papers prepared for this discussion to be comprehensive and excellent.

I want to pause now, Mr. Chairman, to compliment you on your ability to field what I think were some difficult issues raised by earlier speakers, that bear fundamentally on the cooperative character of this organization. I have observed in my time as a member of this Board that management has gone out of its way to respect the sovereign character of member countries. And yet, as you said a few moments ago, we have a burden-sharing issue, and other issues, that need to be brought to the highest levels of our governments. At the same time, I am worried about parts of the discussion today that bear on the financial integrity of this institution. We have avoided rigidity. On the other hand, without rules, no modern system has ever survived. Therefore, there has to be some order in all the procedures of this organization.

As a financial institution, the Fund has financial obligations. Speakers have noted today, as they have in the past, that the Fund is not a bank. It is a cooperative, and therefore the obligations are two sided. As long as we respect the autonomy of member countries, they should respect the financial integrity of this institution.

Returning now to my prepared remarks, we made four principal points at the last discussion of our arrears strategy.

First, we said that the Fund must prevent the emergence of new arrears cases. In this connection, we are disappointed by some recent developments. I believe that we should continue to strengthen our preventive actions. Part of this effort, could be the notification process that the Chairman mentioned earlier.

Notwithstanding some progress in assessing the capacity of members to repay Fund credit, we continue to believe that this effort should be strengthened. I suppose I take the auditor's approach of not wanting to deal in darkness. The more pertinent facts we have, the better. In addition, I think more can be

done to establish special arrangements to facilitate payments in instances where members have overcome an arrears problem, and are prepared to draw again on the Fund's resources. I also think that we should pursue every opportunity to reinforce the preferred creditor status of the Fund. I know that this is not a simple issue. It gets into questions about relationships with other international financial institutions, sovereignty, and the like. Still, I think that more time could be devoted to this matter, because it can help to elevate awareness of this status in the highest levels of government. Furthermore, it might be worthwhile for the staff to pursue methods where, without creating difficulties with the World Bank and bilateral credit agencies, our preferred creditor status could be further clarified and codified.

Second, we have said that arrears should be eliminated at the earliest possible stage. We have had some success in this area. Nevertheless, we have a number of members that appear to be noncooperative. We appreciate the efforts made by some to settle their arrears, but there is clear evidence that a few continue to disregard their obligations to the Fund. This is a focal point of our discussion today as we seek to strengthen our remedial measures.

Third, we have said that effective collaboration with the World Bank will be needed. Here I am concerned with a tendency on the part of the Bank to proceed with credits where some pause might be appropriate. We faced a rather complex case last week, but I think we are going to have to be more sensitive to this problem in the future.

Fourth, we have said that our strategy needs both incentives and disincentives. Incentives we have discussed at length. The progress with intensified collaboration, which I mentioned earlier, is noteworthy. On the other hand, we have to be balanced and avoid offering any inducements that are inappropriate. There is the moral hazard issue that we have to remain sensitive to in implementing our collaborative approach. We are, of course, pleased to see the second support group about to get under way in the case of Somalia. We trust that this will be a more timely and less complex undertaking than our first case.

We also believe that intensified collaboration with members that have not been declared ineligible should be viewed with great caution. As other speakers and the staff have noted, we should remain focused on members that are ineligible.

Turning now to the disincentives, this is probably one of the most complex issues that I have faced since coming to the Fund. We have made good progress, and I think the staff papers

demonstrate that we are now ready to come to grips with the issue. Despite the concern raised by earlier speakers that the Fund might be insensitive to the development process, I do not see a basic problem. In my view, this institution is as sensitive and knowledgeable about the process of economic development in member countries as any other body in the multilateral system. I defy anyone to find another body with higher skill levels or higher sensitivity. That does not mean that we are not occasionally at fault. No one is perfect.

Anyway, although measurable progress has been made in considering disincentives for countries failing to meet their financial obligations, I still sense some reluctance on the part of the staff to furnish the Board with detailed information and analysis of members' ability to pay. This is one area where we are going to have to strive harder, and perhaps establish a bit more detail. For example, we have made earlier requests for cash flow analysis, showing the sources and uses of foreign exchange on a monthly or quarterly basis. From an audit point of view, this is not easy, but the more we know the better. Moreover, I think the refinement of this analysis as we approach the test of cooperation cannot be overemphasized. You and I, Mr. Chairman, have had extensive discussions on how we test cooperation. It is a very delicate judgmental matter, and I know that other members of the Board see it that way. Accordingly, if we can refine and strengthen the areas of information that I have just referred to, it would contribute to better decision making. I also think it would be consistent with our strategy to accelerate somewhat the Board's first substantive discussion of a complaint.

Regarding communication, Directors have commented extensively this morning on this issue. We understand the complexity of communicating with Governors. On the other hand, Mr. Chairman, you have articulated very well the importance of increasing awareness of the problem of arrears. Other Directors have stressed that we approach these matters within a sensitive political process. I agree with that as well. But we must keep in mind the cooperative character of this institution. I think that the involvement of Governors may be essential. The Board can take a very active role. But I do not think the message is getting through all the way, and I believe we need the active participation of Governors no matter how complicated the procedure is. As regards timing, our strong view is that the Board should keep open the possibility of sending a communication prior to a declaration of ineligibility. In addition, we have no objection to including the Bank among the recipients.

On the subject of censure, with regard to conditions for such a declaration, we agree with the three tests suggested by the staff. However, we believe that further thought needs to be

given to including in the censure declaration a deadline for initiating compulsory withdrawal. On the timing, we would suggest that the Board initiate consideration of a censure declaration on the anniversary of a declaration of ineligibility, not automatically, but as a rule of thumb. In the case of countries that are already past that anniversary date and are not cooperating satisfactorily with the Fund, we assume that the Board would want to consider such a declaration at the time of the next scheduled review. As to the competent organ, our preference would be to have the declaration adopted by the Board of Governors, notwithstanding the complexity involved, in order to become a meaningful incentive for cooperation with the Fund. And we agree that this declaration should be made public.

Regarding suspension, as we have noted on earlier occasions, we foresee the complexity of an amendment to the Articles. We want to keep suspension under active consideration as we further refine our arrears management system, but amending the Articles looks like a difficult process. In the meantime, I wonder whether it would be possible to suspend a limited range of voting rights. For example, the most important decisions taken by the Fund are those on which a qualified majority is required. Is it possible that the Fund already has the implied power to suspend a member's right to vote on all except these important decisions? Another question I have relates to representation on the Executive Board. If a member is not exhibiting any meaningful cooperation with the Fund, are there ways to discourage the formal participation of the member in a Board constituency?

The last issue is special charges. We realize that there are several sides to this issue, as Mr. Enoch has demonstrated. We believe that a further examination of this issue would be advisable. There are potential inequities in the way special charges accumulate. At the same time, we are concerned over the concessional element of these charges. Furthermore, where we have support groups helping a member in the process of intensified collaboration, I question the rationale for continuing to levy special charges.

In closing, I know that this chair has taken an extensive amount of the Board's time this morning, as it has on previous occasions, to address the arrears problem. We do it very simply because we wish to emphasize the financial character of this institution, and we are deeply concerned that any further erosion of the Fund's financial situation could have ramifications that would hinder the operations of the Fund and impair the value of our reserve assets.

Mr. Yamazaki said that he agreed with Mr. Warner that the system of special charges merited further consideration.

The Chairman said that note had been taken of the point made by several Directors in that connection.

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

LEO VAN HOUTVEN
Secretary