0404

INTERNATIONAL MONETARY FUND

Secretary's Journal of Executive Board
Informal Session 89/16

3:15 p.m., July 5, 1989

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

Executive Directors	Alternate Executive Directors
	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	
	P. Gorjestani, Temporary
G. Grosche	
	S. P. Shrestha, Temporary
B. Jalan	L. E. N. Fernando, Temporary
A. Kafka	
	W. N. Engert, Temporary
Mawakani Samba	
	I. A. Al-Assaf
H. Ploix	
G. A. Posthumus	
K. Yamazaki	

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; T. Leddy, Deputy Director; G. R. Kincaid. External Relations Department: S. W. Kane. Legal Department: F. P. Gianviti, General Counsel; W. E. Holder, Deputy General Counsel; R. H. Munzberg, Deputy General Counsel; J. W. Head, A. O. Liuksila. Middle Eastern Department: J. Hicklin. Treasurer's Department: D. Williams, Deputy Treasurer; M. P. Blackwell, J. E. Blalock, D. Gupta, D. Ross, G. Wittich. 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, M. Eran, S. M. Hassan, J. M. Jones, P. O. Montórfano, A. Napky, R. Wenzel. Assistants to Executive Directors: S. Appetiti, G. Bindley-Taylor, B. A. Christiansen, Di W., A. Y. El Mahdi, M. A. Ghavam, 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 resumed from the previous meeting (IS/89/15, 7/5/89) their consideration of 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).

Mr. Evans made the following statement:

There is probably little doubt that the extensive, and ongoing, buildup of outstanding obligations to the Fund during the 1980s had had much to do with the general economic climate of that period. Many, if not all, would also agree that it has had much to do with the policies adopted by the countries concerned; with the attitude of this institution when allowing those countries access to Fund resources; and with similarly compromised attitudes on the part of private creditors who have provided such countries with financial resources.

However important the balance of each of those factors may have been in individual cases, it is also clear that there has been a marked change in attitude to the question of arrears during this period. One can see that, for example, in the large number of countries, compared with the early 1980s, which are now prepared to allow themselves to drift into short-term arrears; and, what is perhaps more important, in the tenor of many of the comments made in the course of our discussion this morning.

It seems to me that we will not make progress on this matter until we adopt procedures that can materially affect that attitudinal change. In making suggestions in that regard, we would continue to put stress on measures of a preventive nature--as we would stress the preventive element in all measures. For this, there would appear to be two prime requirements: first, that penalties include elements of a preventive type that are sufficiently clear to decision makers at the time that initial decisions are taken which eventually lead to the buildup of arrears; and second, that there be adequate care exercised by this Board in approving members' access to Fund resources and adequate surveillance of their use of those resources.

One element of penalties, of course, relates to the question of special charges. On that issue, we could support the decision proposed by the staff; but, like some others, we believe that there is a need for further review of the formulas

underlying the various charges. It is far from clear that there is an economic, as distinct from an accounting, rationale underlying the many different rates of charge.

On the question of suspension of membership, we can understand--and indeed agree with--the reluctance of other members to recommend an amendment to the Articles purely for the purpose of providing for the suspension of membership. We would not, however, like to leave the matter at that point because that is likely to tie our hands unnecessarily in the use of what might prove to be a very valuable machine. It is, of course, a very long time since the Articles were drafted. We are now too far removed from the event to understand properly why the original drafters of the Articles chose not to include the power to suspend membership; no doubt it represented one of many compromises then required. In today's changed environment, however, it is surely unusual, to say the least, for there not to be such a power available to the Fund.

I would therefore like to suggest that when we consider this matter in formal session, we should separate the question of the Board's attitude to suspension of membership, per se, from the question of whether the Board would wish to recommend the necessary amendment to the Articles to the Board of Governors. It would be possible, for example, for the Board to conclude that the power to suspend membership is desirable in principle, and, at the same time, to decide that the time is not appropriate to be recommending such a change to Governors. This chair would support such an approach. I believe that if the Board were to reach such a conclusion, it would open the way for further substantive consideration of the matter, and it would avoid the impression that this is a dead issue.

In concluding, I would like to return to Mr. Warner's suggestion that we need an improved early warning system on arrears cases. In doing so, I recall that Mr. Cassell recently had cause to draw the Board's attention to a newspaper article which reported a Board discussion on a sensitive matter (IS/89/11 and IS/89/12, 5/10/89). While sharing his displeasure at that development, I believe that we should be equally concerned with newspaper articles which "report" Board discussions that did not occur, i.e., articles which draw attention to potential arrears cases that the Board has not considered.

I believe that the staff should be particularly vigilant in bringing such cases to the notice of the Board. Arrears do not arise overnight although, once they have arisen, arrears accumulate very quickly, as does the difficulty of dealing with them.

There should be scope for possible arrears cases to be identified at a stage early enough for the Board to convey its concerns to the member concerned. If necessary, the consideration of such cases could be on an informal basis in restricted session. A procedure of this sort would allow the Board to make a contribution--in terms of drawing the situation to the attention of the real decision makers--that may prove more effective than our extensive efforts at remedial action.

Mr. Feldman said that he wished to offer some very preliminary comments. Before taking up the specific issues, he also wished to stress his belief that the Fund should concentrate most of its efforts and resources on further strengthening the collaborative approach. He continued to think that the present approach could not provide an appropriate framework for dealing successfully with the four largest cases of protracted arrears; while it could lead to a stabilization of arrears in those cases, it could not solve the problem of large stocks of arrears. In the four countries with heavy arrears, a tailor-made solution was called for, and should be sought with an open mind, without ruling out, a priori, even some rescheduling. Of course, the precondition for considering such solutions in those cases must be a commitment by the countries themselves to very strong adjustment policies.

On the question of suspension of membership, he had no problem with the staff's conclusions, Mr. Feldman commented. He agreed that there was no legal basis for suspension and that the matter should not be pursued further, nor should an amendment of the Articles be considered. However, the section in the staff paper on implied powers to impose exclusionary sanctions had raised a question in his mind relating to the denial of a quota increase under the Ninth General Review to members in arrears. Two arguments had been put forward to sustain that denial. First, that the quota payment by a member in arrears would add to holdings that the member should have repurchased, and second, that it would be in a currency that would be demonstrably not usable by the Fund. He hoped that those two conditions were taken in combination, because adherence to the second argument--that the currency was demonstrably not usable by the Fund--would preclude a quota increase for a large number of countries.

On the question of censure or declaration of noncooperation, Mr. Feldman considered that the proposed approach was not very convincing and that it would not help to resolve the problem of arrears. Furthermore, the procedure would overlap to some extent with the existing one. However, he wished to support the communication to Governors.

He had noted from the staff's six-monthly report on overdue financial obligations that when analyzing individual cases of members in arrears, the staff was using a more objective indicator to judge whether or not a country was discriminating against the Fund, namely, payments to the Fund--and to other creditors--as a proportion of obligations falling due

during a certain period, Mr. Feldman continued. That was a welcome improvement over the indicator used previously by the staff, namely, payments to the Fund as a proportion of total payments.

Finally, he had no problem with the substance of the communication to Governors, Mr. Feldman said. On the question of the potential addressees, he would like all Governors and all heads of international organizations to receive the communication. For the Board to embark on the selection, as Mr. Enoch had mentioned, could be quite cumbersome and time-consuming. He would favor sending the communication as soon as possible: the earlier it was sent, the more preventive the communication was, and the later it was sent, the more punitive or remedial it became. Once a country had been declared ineligible, it was crucial for it to embark on constructive policies, and not for the Fund to resort to new, remedial measures. He noted that the staff was planning to take into account the responses received from Governors and heads of international financial institutions in subsequent reviews of members' overdue financial obligations. That was all well and good, but the problem then would be how to keep information flowing to Governors so that they were informed of changes in the circumstances of member countries' situations, which might be subject to rapid change, hopefully for the better. But that was a matter for consideration at a later, more formal stage of the Board's discussions.

Mr. Fernández Ordóñez said that his remarks would be general at the present stage of the discussion. First, he wished to stress the importance of adopting effective measures. Their efficacy must be measured by the effect on the member that had incurred overdue obligations to the Fund and also by the effect that the measures had on other members in preventing the emergence of new arrears. Like others, he believed that the Fund should refrain from using procedures that went beyond the remedial to the punitive, and to the point at which they became ineffective. The second point he wished to stress was that the Fund should guarantee that the remedies or punishments were not imposed for purposes other than to defend the financial soundness of the institution. It was essential to be sure that the measures could not be used for political purposes, and the staff papers had not given sufficient assurance in those respects. Further study was called for to ensure that the Fund was not moving into uncharted waters. That members unable to repay the Fund could not use its resources was a given; but in proceeding to impose other sanctions, including declarations of noncooperation, it was also necessary to be sure that the difficulties members were having in fulfilling their obligations to the Fund had not been created by the action of other member countries.

He had been most impressed by two of the issues brought forward by the Chairman during the discussion, Mr. Fernández Ordóñez remarked. First, he very much agreed with the Chairman's response to Mr. Prader concerning the importance of publicity and the interesting use that could be made of publicity as a weapon in the important war against arrears. At the same time, in response to Mr. Monyake, the Chairman had made the point that in examining the root causes of the inability and unwillingness of members to repay the Fund, unwillingness was often the initial cause of

arrears. It would therefore be logical to argue that in making the two propositions consistent, publicity would be more efficacious the earlier it was resorted to. In that sense, he could join others, including Mr. Prader, in suggesting that publicity be given priority even over the declaration of ineligibility. It was perhaps because the Fund was trying to hide the arrears problems of member countries that it was being affected as an institution. But the outcome was simply that the Fund had to apply heavy punishment very late, when light punishment--or no punishment at all, since publicity was not a punishment--could contribute to promoting the type of decision-making process that the Chairman had in mind. For instance, if a central bank governor or minister felt that he had time to delay making payments, the Fund should change that perception, but not seek to punish the member. That was why he believed that the right time for publicity was on the occasion of the Board's review of a member's overdue financial obligations.

In response to a question by the Chairman, Mr. Fernández Ordóñez said that he did not believe that members often fell into arrears because of action taken by other members. But the possibility existed, and it was important to take that possibility into account. Clearly, the Fund could not provide resources to countries that could not pay, whatever the cause, but by entering into the field of sanctions, the Fund would run the risk of politicizing the situation.

Mr. Finaish made the following statement:

> Given the preliminary nature of today's discussion, I will just summarize our tentative views at this stage regarding some of the issues and questions raised in the staff documents.
>
> On the question of the criteria for judging a member as noncooperative, I agree with the staff that the record of payments to the Fund relative to payments to other creditors is a relevant consideration. But as we indicated on previous occasions, this would require that staff documents on individual cases provide more complete information on the member's debt service record, and not only a short table showing gross debt service flows to various creditors. Even if one does not dispute the principle of preferred creditor status, before the Board can judge a member as noncooperative, it has to be informed of the circumstances behind the member's debt service behavior, including the amounts and types of net inflows from various creditors.
>
> Although the question of quota subscriptions by members in arrears has already been settled by the Board, I would like to emphasize again that, in our view, it would be important to provide members with sufficient time to become current before denying them the quota increase. This is particularly relevant

in protracted arrears cases where full settlement under the intensified collaborative approach can take place only after a relatively long process.

On the suggested communication by the Managing Director to Governors and other institutions regarding noncooperating members, we are not yet in a position to draw a firm conclusion about the balance of advantages and disadvantages of this proposal. Further consideration of the matter in light of the comments made by a number of Directors would be useful. In any event, we would not favor a routine or quasi-routine procedure. If the communication is to be effective at all, it has to be used only very sparingly.

Second, we agree that it would be important to bring the matter to the Board before applying this procedure in individual cases.

Third, I am not sure that fixed rules on the timing of the procedure would be useful. But, certainly, communications should not take place before other positive avenues are fully explored with the member.

Fourth, we do not have strong views on the text of the communication proposed by the staff, particularly as it relates to Governors of the Fund. However, the possibility of including other multilateral institutions on the list raises a number of questions, including reciprocal treatment, which I am not sure have been fully considered.

On the question of suspension, I can be very brief. As explained by the staff, suspension affects only the voting rights of the member. Frankly, I do not believe that it would be appropriate to propose to the Board of Governors an amendment to the Articles on this kind of issue. I believe constitutional amendments should be reserved for more fundamental matters.

Finally, on declarations of noncooperation, as a matter of principle we believe that if such declarations are to be agreed by the Board, they should be separate from statements of intention about compulsory withdrawal, which is a far more radical step. But in that case the declaration will simply be a public proclamation by the Fund about members' policies. The question of the legality of such proclamations is addressed by the staff, although I have to confess I am not sure how to interpret the staff's conclusion. Given the restrictiveness of Article XII, Section 8, I am not sure that the legality of a declaration of noncooperation could be based simply on an interpretation which the staff feels that the Board has given to the Articles through its past practice, regardless of the legal soundness of that practice.

Mr. Grosche said that he welcomed the Chairman's comments on Mr. Monyake's intervention at the previous session. Indeed, the aim of the procedures that were being discussed was to make it less attractive for members to fall into the trap of arrears to the Fund. All remedial action had to be preventive. If the Fund was not successful in that endeavor, even more countries might end up suffering severely by being excluded from full participation in the international financial network. He feared that the Fund's intensified collaborative approach might not be able to handle additional cases; those already under consideration were posing enormous problems for donors. He had been disappointed to note that Mr. Monyake was not fully aware of the many efforts donor countries were making to organize additional contributions to the collaborative approach. He hoped sincerely that further cases of protracted arrears to the Fund could be prevented. If not, it might well be that the inevitable deterrent would consist of countries being cut off from significant aid flows for a prolonged time. While he agreed fully with Mr. Posthumus that arrears to the Fund were not linked to the stage of development in a country, the issue of arrears could become one of development aid flows.

Turning to the staff papers, Mr. Grosche said that he wished first to associate himself with Mr. Massé's remark on the short circulation period. His comments on those papers, which had helped to clarify the issues, would necessarily be preliminary. His general impression was that it would be difficult to devise further preventive steps that would make an impression on the member without creating too many problems for the Fund.

He could associate himself with the remarks of Mr. Enoch on the six-monthly report, Mr. Grosche continued. The timing of the proposed communication needed to be clarified. Would there be one communication before and another after the declaration of ineligibility, or only one following that declaration but before the member was censured, which would be his preference? The letter should be substantive, informative, and relay to the addressee in precise terms what the Fund had done and what it planned to do. Only at the end of the letter should the Fund ask for assistance in solving the problem, when and however the addressee might find it suitable. He could broadly support the staff proposal for a possible declaration of noncooperation, despite his concern that the procedure might prove to be rather ineffective. However, if the Board of Governors were to endorse the declaration, including an announcement that the procedure of compulsory withdrawal would be initiated at a specific date, the declaration might be productive. But he doubted whether the Board of Governors could follow such a course. Nevertheless, a declaration of noncooperation could give some new impetus to efforts to bring members back into the international financial arena.

On more technical points, Mr. Grosche stated that the tests relevant to assess whether or not a member was cooperating should rely as much as possible on quantitative criteria. Ideally, noncooperation should be established almost automatically--for instance, if the member remained in arrears after being declared ineligible, for, say, longer than 12-18 months without a program in place to remedy the situation. In that

context, the amount of arrears seemed less relevant. Another criterion, but one that was not always easy to establish, was whether other creditors had been better serviced. The text of the communication as drafted by the staff appeared to be appropriate, except for the last paragraph calling on other members to cooperate, which should be deleted. Whether the Executive Board or the Board of Governors should endorse the declaration depended on whether or not the statement included a sentence announcing the possibility of withdrawal. The declaration should be made public, in his view.

Finally, he had been impressed by the staff paper on the suspension of membership, Mr. Grosche said. The potential results of an amendment did not make the effort worthwhile, and the issue should be dropped.

In response to a question by the Chairman, Mr. Grosche said that he could go along with Mr. Evans's suggestion that the Board state in principle that it would be useful for the Fund to be able to suspend membership, but that for the time being, such action would be premature, given the difficulties of amending the Articles. Basically, his view was that withdrawing a member's voting power was not a sufficiently significant change in its membership status to justify the extremely difficult procedure of amending the Articles of Agreement.

Mr. Jalan commented that the issue seemed rather hypothetical in the sense that if the present was not the right time to amend the Articles, it would be difficult to know what the right time would be. Therefore, he saw little merit in the Executive Board adopting such a qualified position because the Governors would be uncertain as to the Board's intent.

Mr. Kafka said that like Mr. Jalan, he saw no point in such a self-contradictory approach. A declaration by the Executive Board that it would be helpful to be able to suspend membership but not at present would convey the message that overdue financial obligations were not important enough to activate the process of amending the Articles of Agreement.

Mr. Warner said that perhaps it was rather that although it was the right time, amending the Articles was such a difficult process, that amendment for that purpose would have to be deferred until such time as the Articles were amended for other reasons. An expression by the Executive Board of its intention at some future date to amend the Articles would surely convey the impression that the issue of suspension, for good cause, should not be shelved.

Mr. Monyake, responding to the point made by Mr. Posthumus and echoed by Mr. Grosche, among others, about not linking protracted arrears to underdevelopment or to the development process, asked whether it could in fact be stated that protracted arrears did not only manifest themselves in developing countries. As far as he knew, no developed country was suffering from the phenomenon of arrears; and he would be grateful for further enlightenment from Mr. Grosche or Mr. Posthumus on their position,

given that his own observation had been that the problem appeared only in developing countries and in countries experiencing difficulty in implementing development programs.

The idea that he had been attempting to convey, Mr. Monyake continued, was that before harsh measures were even considered, the situation and root causes of a country's difficulties should be analyzed in an attempt to understand them. At the same time, he appreciated the need not to wait until symptoms that showed up early enough had become a serious problem so that corrective action could be taken in time. But it would still be necessary to find out the root causes of those symptoms.

He was not sure that he would agree with the Chairman that it was unwillingness at the beginning and inability at a later stage, Mr. Monyake said. Even if initial unwillingness to pay later became inability, the question was to determine what led to unwillingness among a particular category of countries. No developed country so far had exhibited unwillingness that later led to inability and protracted arrears.

In response to Mr. Grosche's remarks, Mr. Monyake continued, it was not that he was not fully aware of the efforts of donors in the intensified collaborative approach. His point was that the needed resources were slow in coming and were not in the required amounts. Financing gaps were not being bridged quickly enough, and he felt sure that those involved in trying to coordinate the intensified collaborative approach would testify to that fact. Certainly, the donor community was pressing its willingness to help and to participate in the Fund's endeavors, and he recognized that they faced problems of their own.

The approach that he would personally encourage was that taken by the Managing Director, who had initiated a number of actions designed to help the authorities in member countries experiencing payment difficulties to understand and to solve their problems, Mr. Monyake concluded. That approach was not a punitive one and it had had positive results. He would prefer to move further in that direction before entering into a debate on remedial or punitive measures.

The Chairman said that whatever action had been taken had been carried out in the name of the Executive Board. He could not have embarked on contacts with member countries with payments difficulties without the full support of all the Executive Directors. Certainly, the cooperative strategy of remaining in touch with the authorities in member countries must continue, but to be effective, it must be made credible. Resort to remedial action was unpleasant, but such action was an integral part of supportive measures and made them more efficient.

He also continued to disagree somewhat with Mr. Monyake's shaded assessment of the efficiency of support groups, the Chairman continued. While the amounts being made available were not fully meeting the requirements, and were being made available somewhat more slowly than expected, the President and Government of Guyana had found it hard to believe that

an institution had been able to mobilize international financial support in an amount that was sufficient for them to launch, without hesitation, a program. When the essential financing was made available, even if it was not 100 percent of the amount needed, the balance could reasonably be expected to follow. The momentum imparted to international cooperation had led to a complete change in the environment.

He continued to be unconvinced of the relevance of a link between arrears and development, the Chairman added. It was striking that among the four member countries with the most protracted and heavy arrears, two were far from being among the poorest of the Fund's members, or the poorest in their own regions, Latin America and Africa. Indeed, they were countries with significant resources, but both had made bad economic policy choices and possibly had suffered from poor economic management. At the same time, they were imposing a heavy burden on the poorest members. A cooperative institution had to be managed strongly so that arrears could be eliminated. He looked forward to helping all member countries resolve their arrears problems, including the two countries he had in mind, but if positive support was not sufficient, remedial measures would have to be taken, and not only to solve the country's own problems, but because arrears were destructive of the cooperative.

The difficulties that the Fund might experience with the pending increase in quotas was an example of the costs of arrears to the Fund, the Chairman added. The costs of borrowing from the Fund would also continue to rise. Once countries embarked on a course of allowing arrears to develop, they discovered that they had embarked on a dangerous route. One of the conclusions that could be drawn from the present discussion was that if the Fund was to be credible at an early stage, it had to be active at an early stage. If it could not prevent arrears, it at least had to be able to make the leaders of member countries fully aware of the dangerous path on which they were embarked.

Mr. Grosche said that he could not have explained the situation better. It could not be denied that all countries in arrears to the Fund were developing countries, but there was no link between the stage of their development and arrears. The problem of arrears was specific to the countries concerned, as noted by the Chairman.

Mr. Jalan said that it was perhaps too early to know whether the tremendous effort that donor governments and debtor countries, as well as support groups in general, had been making in mobilizing resources would be fully successful. Nevertheless, it might be useful for management or staff to consider, based on experience with the efforts that were already being made on behalf of specific countries, ways to strengthen further the process of obtaining commitments from donors. Obviously, each government had to make its own decision, but that decision would depend on the decisions taken by others. The whole process of putting together a financing package could take a considerable period, from the time when a debtor country in arrears expressed interest in the collaborative approach, took prior action in agreement with the Fund, which estimated

the financing needs, and then with the Fund's concurrence, announced to the world that it was taking advantage of the collaborative approach. It was difficult enough to reach agreement on a Paris Club rescheduling, which did not even involve any new money. For a country to receive flows of new money, a long sequence of events had to take place. Meanwhile, the debtor country which had agreed on a program was undergoing both domestic as well as international traumatic experiences, and might also be encountering problems in implementing its program if money was not available. In sum, his point was to know whether some procedural innovations could not be devised to strengthen the role of donors in the intensified collaborative approach, based on the Fund's experience so far.

The Chairman remarked that Mr. Jalan had made an important point. Mr. Posthumus had made a similar point in mentioning the Fund's relations with the Paris Club. Imaginative proposals were helpful, and would be given further consideration. Furthermore, the purpose of the discussion was to convey ideas and suggestions to the membership.

Mr. Kafka said that certain remarks by Mr. Enoch and Mr. Grosche had seemed to him to suggest that they thought that the intensified collaborative approach was not likely to be of benefit to many more countries. He asked whether his impression was correct or not.

The Chairman said that he hoped that Mr. Kafka's impression was wrong. Certainly the facts did not support it.

Mr. Enoch said that he had not intended to convey that impression. His point was that the process of resolving arrears was not straightforward. Apart from all the usual problems that arrears caused the institution, the organizational problems and the amount of manpower involved in the collaborative approach--as the amount of effort made on behalf of Guyana showed--set a limit to the number of countries that could benefit from the approach. There was also a limit to the amount of available resources.

Mr. Grosche said that he agreed that there were certain limits in terms of the ability to handle such cases. Even in terms of budgetary contributions, resources could not be shifted indefinitely toward the collaborative approach. Therefore, every effort should be made to prevent new cases of arrears from arising if the approach on which the Fund was currently embarked was to be an efficient, workable one.

The Chairman commented that the problem of arrears certainly placed a great drain on members' resources as well as on the Fund's resources, including the time and effort devoted by the staff and the Board, which had been preoccupied with overdue financial obligations during the past 12 months. But it was a vital question for the institution, and the sooner there was a little more light at the end of the tunnel, the better it would be for the Fund. True, there was also a drain on members' resources. He accepted Mr. Grosche's point on budget aid limits, but he continued to believe that the Fund must go on explaining to aid agencies

that they could make no better investment than by helping the Fund settle the problem of overdue financial obligations. Once that problem was settled, and if the Fund was able to become a true partner of the countries that had been in difficulties, then the conditions for action by those countries would improve dramatically. Great progress was being made in promoting a mutual understanding along those lines, but a further effort was called for. That was one of the reasons why he would take the opportunity, in attending the Tidewater Meeting of the heads of development agencies, to explain why the Fund needed their financial assistance on behalf of its member countries and why it was in the agencies' interest that the collaborative approach succeed.

The General Counsel said that the statement in Section II, paragraph 9 of the staff paper on the suspension of membership, relating to the basis for determining that payment of a quota increase would not be appropriate for a member in arrears, had a precise basis in Article V, Section 7(h). The Fund was authorized under that provision to adopt special policies for the sale of the currency of a member in arrears that was not repurchasing its currency from the Fund, which had found it impossible to sell the currency. It was the combination of those two factors--arrears to the Fund and nonusable currencies--that was the basis for the statement in the staff paper to which Mr. Feldman had referred.

The observations that had been made with respect to publication raised numerous interesting issues, which he would attempt to outline, the General Counsel continued. A careful reading of the legal papers would show that the staff had been very cautious in its conclusions relating to the interpretation of the obscure provisions of the Articles of Agreement, which had not attracted much attention at Bretton Woods or since. Indeed, he had noted that the staff paper on the publication of declarations of ineligibility issued in 1985 had not discussed the legal basis for such publication but had taken for granted that the Fund had the power to publish them.

The general principle, in Article XII, Section 7(b), was that the Fund may publish such reports as it deemed desirable for carrying out its purposes--other than the financial statements, which were covered under Section 7(a). However, Section 8 of Article XII contained one limitation and one exclusion. The limitation was that "the Fund may, by a 70 percent majority of the total voting power, decide to publish a report made to a member regarding its monetary or economic conditions and developments which directly tend to produce a serious disequilibrium in the international balance of payments of members." The word "may" was of interest because it would not have been used unless there was an implicit prohibition. It was not stated, for example, that the Fund may publish such a report only in certain, specified conditions. There was a clear prohibition, to which there was no exception, in the last sentence of Article XII, Section 8, which stated that "the Fund shall not publish a

report involving changes in the fundamental structure of the economic organization of members." The combination of the provisions reflected in the two sentences that he had cited from Section 8 of Article XII constituted the general principle for the Fund's publication of reports, but with some limitation.

The scope of that limitation was evident from an analysis of the statement in Section 8 that what was envisaged was a report on the member's monetary or economic conditions and developments which directly tended to produce a serious disequilibrium in the international balance of payments of members, the General Counsel observed. It could be said that whenever views were expressed on a member's economic policies, they could not be published unless those policies tended to pose a serious disequilibrium, and only with a majority of 70 percent of the total voting power. It would be reasonable to say that in all other cases, namely, when the member's policies did not tend to produce a serious disequilibrium, publication was possible because it was outside the scope of Section 8 of Article XII.

In the absence of any legislative history on which to determine the meaning of the provisions in the Articles on publication, it was necessary to rest on the recognized principle of international law, the General Counsel noted. That principle of international law, and of international organizations in particular, was that the practice of an organization could be taken into consideration in the same way that it could in the application of a treaty. The most interesting example of a publication in a conflict between the Fund and a member was the press release issued in 1948 dealing with the unauthorized devaluation of the French franc. The press release consisted of a long statement by the Managing Director of the Fund, with the approval of the Executive Board, made on behalf of the Fund, and expressing its views on the Fund's policies. There was nothing in the Legal Department's files to show that a prior finding had been made that the policies of the French Government tended to produce a serious disequilibrium in the world's balance of payments. Therefore, the basis for the press release seemed to have been the interpretation that he had mentioned for publishing reports that dealt not so much with a member's economic policies but rather with a member's compliance with its obligations under the Articles.

Thus, a distinction would be made between two types of view of the Fund, the General Counsel noted. The Fund's views on a member's economic policies in general could not be published except when those policies tended to produce a serious disequilibrium, whereas the Fund's views--or rather reminders from the Fund to the member--that it had obligations to discharge under the Articles could be published. That interpretation of the provisions in the Articles on publication was supported by the further recent practice of the Fund in publishing declarations of ineligibility. Those declarations obviously implied a view by the Fund, which was made public to the world in a press release, that a member was in breach of its obligations to the Fund.

Mr. Kafka asked whether the type of declaration of noncooperation suggested in Section I, paragraph 2 of EBS/89/128 did not really go beyond a statement or reminder of obligations. The first and second paragraphs of the formulation proposed for the declaration were statements of facts, the third urged the member to behave, the fourth went somewhat further, the fifth paragraph was questionable in any case, and the sixth and last paragraph also went a little beyond a statement of fact and reminder because it referred to the problem created by the arrears. To be consistent with the General Counsel's argument, the declaration--if it were otherwise admissible, and he did not accept that it was--would have to be modified.

The Chairman noted that the purpose of the meeting was precisely to improve the drafting.

The General Counsel said that without going into a detailed drafting discussion, it could be clearly stated that the basis for such a declaration of noncooperation could only be that the member was not complying with obligations under the Articles. As far as the formulation of the declaration was concerned, the first paragraph indicated that the arrears had not been discharged and was thus a finding that the obligation continued. The second paragraph was an indication that in addition to the nondischarge of an obligation, the fact that the member had made other payments showed an unwillingness on its part to discharge its obligations to the Fund. That was a relevant indication in view of the distinction made in the staff paper between the mere nonperformance of an obligation, which might be due to unwillingness or inability, and the willful breach of obligation. The third paragraph urged the member to discharge its obligations, and it seemed fairly obvious that an institution was entitled to remind the member that it must discharge its obligations where they existed. The fourth paragraph was a reminder of the detrimental effect of the breach of obligation and thus of its seriousness. While that paragraph seemed to have a moral connotation that might seem objectionable to some, those effects were part of the reason for making a declaration or possibly even for moving toward other decisions, such as initiating the procedure for compulsory withdrawal. Therefore, the fifth paragraph was a reminder of possible sanctions under the Articles. The final paragraph differed but there again it addressed a different question, namely, was there anything out of the ordinary in calling on all members to cooperate with the Fund. Furthermore, such a declaration was not an expression of views on the member's policy, and did not therefore seem to have the characteristics of a report that the Fund should not publish.

Mr. Kafka remarked that he had unwittingly misled the General Counsel in referring to paragraph 2 as stating facts. The reference at the end of paragraph 2 to the member not having adopted policies that would ensure the discharge of its obligations was a view which the country might contest. The member might say that it had adopted policies but that its terms of trade had deteriorated, or other exogenous developments had occurred.

The General Counsel said that he took Mr. Kafka's point, which merited consideration.

The Deputy Treasurer noted that sending a communication as a preventive measure, rather than as a remedial measure, was not precluded. In fact, as the Managing Director had indicated in his statement to the Interim Committee in April, the Fund would send a communication quite early in the process of dealing with members' overdue obligations, to notify Governors of the emergence of arrears and to seek their assistance. No such preventive letter had yet been dispatched, because it had not seemed appropriate in any particular case. In any case, before sending such a communication, the Managing Director would have consulted the Executive Directors. The remedial letter would follow the declaration of ineligibility and would be considered in the context of the first post-ineligibility review. The purpose of that letter would also be to elicit the help of Governors in assisting the member to resume payments to the Fund as soon as feasible.

The criterion considered by the staff for addressing communications to bilateral and multilateral creditors--namely, that they account individually for more than 3 percent of the total bilateral and multilateral debt of the member in arrears--would cover between 74 percent and 80 percent of the total debt of three of the four members with the largest arrears to the Fund, the Deputy Treasurer explained. In those three cases, the communications would go to 14 Fund Governors. As to whether such a communication to the World Bank would create any problems, the staff felt that its collaboration with the World Bank was so close that there would be no particular reason to send a specific letter. In due course, the World Bank might wish to express concurrence with the Fund's letters, and when appropriate, perhaps sign them jointly with the Fund. However, for the time being, the Fund was a little further ahead in devising procedures for dealing with its arrears.

The Chairman noted that conversations were being held with the World Bank and there was a possibility that such a common letter could be considered soon, even though the Executive Directors of the World Bank were less advanced in handling the issues.

The Deputy Treasurer noted that there was general support for the proposed decision on the review of special charges. One question that had been raised was whether special charges on overdue payments to the Trust Fund acted as a deterrent. It would be recalled that the special charge on overdue repayments to the Trust Fund was only half of the SDR rate of charge on overdue repurchases to the General Resources Account. The Board had decided in 1986 to retain the concessional element in all Trust Fund operations. Whether or not the special charge was a deterrent was a question that was applicable not only to overdue repayments to the Trust Fund but to all overdue obligations. Nevertheless, it was interesting to note that many members having overdue obligations in both the SDR Department and the General Department, as well as the Trust Fund, often repaid

the Trust Fund or paid interest on Trust Fund loans ahead of obligations to the General Resources Account or the SDR Department. Therefore, the special charge might well be a deterrent in the context of the Trust Fund.

As for whether the decision on special charges should be reconsidered in the future, the Deputy Treasurer recalled that the Executive Board had previously considered three aspects of the system of special charges. First, consideration had been given to imposing an administrative fee, in line with the loss recovery nature of the system of special charges. Apart from the legal issues that could arise in setting an administrative fee, its imposition might be impractical, and the circumstances and manner of its imposition would also have to be determined. Second, the Managing Director had on an earlier occasion suggested that the Board might consider refunding the special charge to members who had cleared their arrears and were cooperating with the Fund. The Executive Board had not taken to the idea, not necessarily because it would lighten the penalty aspect of special charges, but rather because it would conflict with the intended cost recovery, delayed as that recovery might be. Third, the Executive Board had considered penalty charges on various occasions but had concluded that, in present circumstances, they would be inappropriate. Those three aspects of the existing system of special charges could however be reviewed.

As to how the Fund could keep open the channel of communications with Governors after it had sent a communication of a remedial character, following the post-ineligibility review, the Deputy Treasurer said that from a technical point of view, the final paragraph of the communication, inviting the views of Governors, was in fact the way in which the Fund would ask not only what action other member countries were taking and what their opinions were, but also a way of leaving open the possibility of a further response after consultation with the Executive Board.

Mr. Warner explained that his question had been related to the desirability of considering a flat rate charge, applicable to any breach of obligations. As far as penalties were concerned, the statistics appeared to indicate that for members in intractable arrears, the Fund was stacking stones in a sinking ship. Therefore, notwithstanding the need to be aware of the cost recovery nature of special charges, he had been led to look ahead to the possible success of the collaborative process, or of situations of arrears that might be resolved outside of that process. Once normal relations were restored between the Fund and the member, some rational provision might perhaps be built into the system of charges to undo the compounding effect of the extraordinary charges that had built up over several years.

The Chairman noted that during the days ahead, the staff would prepare a clearer presentation of some of the elements of the proposed strategy for dealing with members in arrears to the Fund, based on its sense of the main thrust of the positions of the Board.

LEO VAN HOUTVEN
Secretary