April 14, 1997
Approval: 4/21/97

INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 97/6

10:00 a.m., January 27, 1997

Contents

Attendance . . . . Page 1

1. New Arrangements to Borrow—Establishment; and Transferability of Claims . . . . Page 3
2. Tonga—1996 Article IV Consultation . . . . Page 29

Decisions Taken Since Previous Board Meeting

3. Pakistan—Waiver of Applicability of Performance Criteria . . . . Page 36
4. Sudan—Overdue Financial Obligations—Report and Complaint Under Rule S-1 . . . . Page 36
5. Approval of Minutes . . . . Page 37
6. Executive Board Travel . . . . Page 37

Executive Board Attendance

M. Camdessus, Chairman
P.R. Narvekar, Acting Chairman

Executive Directors	Alternate Executive Directors
A.A. Al-Tuwaijri	S.M. Al-Turki
M.-A. Autheman	
T.A. Bernes	T. Turner-Huggins, Temporary
	W.-D. Donecker
	J. Shields
E.R. Grilli	N. Coumbis
	J.P. de Morais
	P.A. Akatu, Temporary
D. Kaeser	
	J. John, Temporary
W. Kiekens	J. Prader
	B.S. Newman
H. Mesaki	H. Ogushi, Temporary
A. Mirakhor	
	A. Vernikov
	Y.Y. Mohammed
M.R. Sivaraman	H.B. Disanayaka
	B. Andersen
	J.L. Pascual, Temporary
E.L. Waterman	A.G. Yaqub, Temporary
J. de Beaufort Wijnholds	
	A. Barro Chambrier
Zamani A.G.	S. Joyosumarto
Zhang Z.	Han M.
	J. Leiva

R.H. Munzberg, Secretary
S. Bhatia, Assistant

Also Present
IBRD: H. Codippily, East Asia and Pacific Regional Office. Asia and Pacific Department: A. Singh, Deputy Director; J.H. Felman, N.N. Hairfield, A.A.F. Op de Beke, H. Shimizu. External Relations Department: S.J. Anjaria, Director; C. Hellemaa. Legal Department: F.P. Gianviti, General Counsel; H. Elizalde. Monetary and Exchange Affairs Department: J.M. Jimenez. Policy Development and Review Department: J.T. Boorman, Director; N.L. Happe, J. Pujol. Research Department: M. Mussa, Economic Counsellor and Director; P.B. Clark. Secretary's Department: W.S. Tseng, Deputy Director; P. Gotur, A. Mountford. Treasurer's Department: D. Williams, Treasurer; D. Gupta, Deputy Treasurer; K. Boese, E. Decarli. Office of the Managing Director: S. Sugisaki, Special Advisor; J.A. Quick, Personal Assistant. Advisors to Executive Directors: M.B. Alemán, M. Askari-Rankouhi, A. Cserés, T.K. Gaspard, C.M. Gonzalez, He J., G.M. Iradian, M.-H. Mahdavian, M.F. Melhem, O. Otazú. Assistants to Executive Directors: W.F. Abdelati, J.G. Borpujari, M.A. Brooke, H.W. Cocker, D.A.A. Daco, J.C. Estrella, B. Grikinyté, R.J. Heinbuecher, M. Kell, J.P. Leijdekker, D.G. Loevinger, J.A.K. Munthali, L. Palei, L. Pinzani, T. Presečan, S. Rouai, D. Saha, Song J., U.Y. Tilyayev, R.P. Watal, M. Yiu, Zheng H., Zubir bin Abdullah.

1. NEW ARRANGEMENTS TO BORROW—ESTABLISHMENT; AND TRANSFERABILITY OF CLAIMS

The Executive Directors considered a staff paper on the establishment of the New Arrangements to Borrow (SM/96/307, 12/31/96).

The General Counsel made the following statement:

> In response to questions we have received before this meeting, and for the record, I would like to dispel any ambiguity that may have arisen concerning a particular sentence in the staff paper on the New Arrangements to Borrow (NAB). Specifically, I am referring to the text of footnote 11 on page 3 of the paper.
>
> The purpose of this footnote is to clarify the procedure that will be followed to determine whether the Hong Kong Monetary Authority (HKMA) may opt out of a proposal or be excluded from calls. The criterion, as stated in paragraph 1(b)(iii) of the proposed decision, is the balance of payments and reserve position of Hong Kong itself, and the staff paper (page 3, third bullet) clarifies that this provision does not allow the taking into account of the balance of payments and reserve position of the member whose territories include Hong Kong.
>
> Since the currency of Hong Kong is not and will not be used by the Fund, the procedure specified in the first sentence of paragraphs 7A(c) and 7B(b) is inapplicable. The only procedure that can be envisaged to assess the balance of payments and reserve position of Hong Kong is a consultation between the HKMA and the Fund as specified in the second sentence of the same paragraphs.
>
> In this regard, I should point out that footnote 11 of the staff paper does not state that the second sentence of these paragraphs will apply but only that the procedure specified in that sentence will apply. This choice of words was deliberate: the use of the word "procedure" means that only the second clause of that sentence will apply, since the first clause has no procedural content. Therefore, the footnote contains no implication whatsoever that the Hong Kong Monetary Authority is an institution of a nonmember.

The Treasurer observed that the staff had received a letter of consent from the U.S. authorities for the use of U.S. dollars in loans by the Hong Kong Monetary Authority to the Fund under the New Arrangements to Borrow; the U.K. authorities had given their concurrence to the participation of the Hong Kong Monetary Authority in the NAB.

Mr. Waterman made the following statement:

> It is clear looking back that the Mexican crisis in many ways focused attention on the implications of the changing global economy for the Fund, including the implications for possible calls on Fund resources in a world where information is transmitted instantaneously, where capital moves both quickly

and in larger volumes and where the risks of contagion are larger than they used to be.

While the General Arrangements to Borrow (GAB) have been revised and extended in the past, the growth and changing structure of the global economy have resulted in a need to increase the resources available to the Fund during times of financial emergencies. The G7 recognized this explicitly in calling for a doubling of the amount available under the GAB at the time of the Halifax Summit in 1995. The G7 also recognized the importance of involving other countries with the capacity to support the system.

The NAB will enhance the Fund's ability to safeguard the international monetary system. Wider participation and the accordance of equal rights and responsibilities for all participants in the new arrangement reflect appropriately the changing characteristics of the global economy. In addition, the NAB will provide a new forum in which participants can meet and discuss issues of international importance. In many ways the establishment of the NAB as the Fund's principal borrowing facility is a milestone both for the Fund and for global economy more generally.

Against this background, we are pleased that agreement has been reached amongst the participants on the operational details for the new arrangements. For their part, management and staff have reported to the Board on how the discussions on the detailed arrangements have been progressing on a number of occasions over the past year. My understanding is that the proposed decision in the staff paper accurately reflects the arrangements that have been agreed by potential participants. And Korea and Australia from this constituency are very pleased to play a role in the new arrangements. It is obviously important for us to push the arrangement toward completion by agreeing to the operational and legal details today. Potential participants will also need to push ahead as quickly as possible in implementing the steps necessary to adhere to the NAB. In Australia's case, we will need to introduce appropriate legislation, but it is the intention of my authorities to undertake this prior to the Annual Meetings in Hong Kong later this year.

Finally, I would like to extend the appreciation of my authorities for the efforts and work of staff throughout the NAB negotiations.

Mr. Mesaki made the following statement:

Following the call at the Halifax Summit for a doubling of financing capacity of the GAB, there are numerous discussions on this subject among the G-10 members and new participants, which ultimately led to a final agreement on the framework for the new arrangements, the list of participants, and the credit arrangements for each participant. Japan also made every effort toward a final agreement, under the instruction of former Finance Minister Kubo, who was the Chairman of the G-10 until last October.

I would like to take this opportunity to express our admiration for the participants in the discussion process, including the Fund staff. I also wish to express our appreciation for the tireless work of the participants, especially Mr. Bernes and others, who were the real driving force behind the final agreement. I can support the proposed decisions, including the decision on transferability of claims.

In view of the increasing volume of the international capital flows and integration of the emerging economies into the world economy, it is quite significant that we have reached this final agreement, which would enable the Fund to respond fully to the systemic risks in the international financial markets. I hope that this agreement is approved by the Board and that the NAB will become effective soon, after prompt adherence to the arrangement by participants. Japan is also determined to proceed swiftly with the domestic approval process and to adhere to this arrangement as soon as possible.

Mr. Leiva made the following statement:

Nineteen months after the call of the Halifax Summit to develop arrangements enabling the Fund to respond to financial emergencies, we are considering a text already agreed by the twenty-five participants on the New Arrangements to Borrow. I would like to begin by acknowledging the work done by the G-10 deputies, the representatives of participating members and members' institutions and the staff to present an agreement which, after the approval of this Board, can be adhered to.

This chair welcomes the agreement reached on the New Arrangements to Borrow as presented in the paper prepared for this meeting. I will make only three brief comments on some of the agreement's features: the financing of nonparticipants BOP needs, the conditions required to activate the arrangements and the importance of strengthening the Fund's own resources.

First, on the possibility of financing nonparticipants' balance of payments needs through the NAB, as the paper notes, there are a number of differences between activation of the NAB for participants and nonparticipants. What is of paramount importance is that in the event of balance of payments problems of any of the Fund's members, the NAB could be activated to deal with an emergency in the international monetary system.

Second, on the conditions required to activate the NAB, the NAB are to be activated in exceptional circumstances and several conditions are to be met before the Fund can borrow resources from the participants in these arrangements:

Two conditions refer to the actual circumstances under which the Managing Director can make a call under the NAB. The first one is the existence of an international financial emergency. An exceptional situation, affecting a Fund member's Balance of Payments that is impairing the international monetary system or can threaten its stability must be present. In addition, another circumstance has to concur with an international emergency: the Fund's resources must need to be supplemented to meet actual and expected requests for financing for operations designed to deal with the emergency situation.

After the Managing Director has assessed that these two conditions are present in a given situation, the approval of three different bodies will be required. In the first place, the authorities of the Fund member affected by the emergency must approve a program that is acceptable to the Fund to deal with its balance of payments problems. After the request has been made, this Board must approve the program, the amount requested and the call under the NAB. Finally, NAB participants must approve the loans to the Fund by a favorable decision of, at least, 80 percent majority of the total credit arrangements of participants eligible to vote.

All these conditions might become very cumbersome for emergencies that normally will need prompt reaction from the Fund. The NAB's usefulness will critically depend on achieving, maintaining and enhancing what, using strategic terms, I would call "the readiness of its rapid reaction capabilities." The regular meetings of NAB participants should play an important role to avoid any delay in activating the arrangements when needed. The review of the developments in the international monetary system should maintain the participants aware of eventual problems that could impair the system. I wonder if a once-a-year review is enough for this purpose. In addition to the monetary system reviews during regular meetings, a periodic assessment of the procedural and administrative arrangements would be convenient to enhance the NAB's "rapid reaction capabilities."

Third, on the importance of strengthening the Fund's own resources, being the NAB a tool to be used in dealing with emergencies in the international monetary system, the best anyone can hope for is that the need for activating them will never arises. Moreover, even if such an emergency were to occur, the NAB are a tool to be used in situations in which the Fund should not find itself involved, except in the most exceptional circumstances. I am referring to the situation in which the Fund's own resources are insufficient for the financing of an operation required to deal with a problem that could threaten the stability of the international monetary system.

For these reasons I consider the approval of the NAB an appropriate occasion to highlight the importance of strengthening the Fund's own resources through timely implementation of the Eleventh Review of Quotas in proportion to the needs that may arise from expanding a world economy and increasingly globalized international financial markets.

Mr. Donecker made the following statement:

The proposed NAB is the result of the expected NAB participants' willingness to co-operate to support the Fund in those special situations when it needs supplementary resources to forestall or cope with an impairment of the international monetary system or to deal with an exceptional situation that poses a threat to the stability of that system.

We are asked today to decide on behalf of the Fund if the Fund should accept or reject this generous offer. The international community owes Mr. Draghi, Mr. Bernes, Mr. Noyer and the secretaries to the group special thanks for their important contributions to this project.

As can be seen from the Annex on page 28, Germany, represented by the Deutsche Bundesbank, and Japan will participate with the second largest credit arrangements under the NAB if and when it is ratified by the Fund and the NAB participants.

This is yet another example of our willingness to share in the responsibility for the maintenance of a stable international monetary system and to cooperate closely in this respect with our G 10 partners and the other NAB participants and all members of this Board.

We trust that all NAB participants will carry their fair share of the financial burden if and when the Fund should find it necessary to make calls under the NAB in accordance with the NAB agreement.

We believe that these New Arrangements to Borrow can be very beneficial if they are used wisely only for the intended purposes. We therefore support the proposed two decisions.

However, we, like others, also see the risk that this doubling of the Fund's refinancing lines entails a large "moral hazard" element inasmuch as it might be misunderstood—or deliberately misinterpreted—as a signal that the Fund from now on could be more willing to participate in "bail-out"operations and/or more inclined to provide generous financing without due regard to its essentially quota-based liquidity.

For this reason, calls on the NAB must be strictly limited to the very exceptional circumstances specified in the NAB agreement. The Fund must continue its prudent liquidity management.

It is to be hoped that the Fund's much strengthened surveillance activities together with the wide acceptance of the Special Data Dissemination Standards will help to avoid any need to activate the NAB.

The New Arrangements to Borrow are certainly no substitute for adequate quota increases. The 11th General Quota Review should be speedily concluded in order to provide the Fund in a timely fashion with sufficient quota resources.

Mr. Kaeser made the following statement:

I will simply state that my authorities are very satisfied with the solution which has been found to double the borrowing capacity of the Fund. They wish to express their appreciation to those who devoted a great amount of skill, time and energy to set up a workable arrangement. The adherence of new participants is especially welcome as it does reflect the change which has occurred in the world since the sixties. We cannot conceal some disappointment in the fact that the 13 new participants will only contribute 16 percent of the NAB.

We also welcome the fact that the agreement makes the adherence of new participants possible without requesting the unanimity of the original participants.

Finally, it goes almost without saying that the doubling of the borrowing capacity of the Fund is no substitute for a quota increase. The work on the Eleventh Review has to go on with the view to conclude it in the near future.

Mr. Al-Tuwaijri made the following statement:

I welcome today's meeting on the New Arrangements to Borrow. I am gratified by the breadth of participation and the constructive nature of the discussions that led to the agreement. The staff's contribution to these discussions is appreciated. Saudi Arabia which has always been a strong supporter of the Fund is pleased to be a major participant in the NAB. Indeed, this will build on our borrowing arrangement in association with the GAB.

Putting the NAB in place provides the Fund with a flexible and efficient option to deal with systemic crises. While I hope that such a crisis never occurs, the Fund should be equipped to respond in case it does. The Fund's major contribution here should remain one of helping the authorities formulate strong adjustment programs, in order to restore confidence and attract private financing. The Fund's ability to provide exceptional financing in a crisis, however, will also play a major role in achieving those objectives.

With these remarks, I fully support the proposed decisions.

Mr. Zhang made the following statement:

At the outset, I would like to commend the staff for their tremendous assistance in developing a draft instrument of the New Arrangements to Borrow (NAB). Their efforts and professionalism make the legal and operational details of NAB clearly understandable.

With the rapid changes in the global economy and financial markets, the Fund's role in preventing and coping with crisis situations that may threaten the international monetary system needs to be further strengthened. In this respect, we welcome the establishment of NAB, which would enhance the Fund's ability to respond to financial emergencies. Meanwhile, it needs to be reiterated that, as a quota-based institution, the Fund's operational needs should mainly be financed by the increase in members' quotas; NAB, and any other form of borrowing, should only serve as supplementary resources to the Fund.

> We are pleased to note that common consensus has been reached that the Hong Kong Monetary Authority (HKMA) will be participating in NAB as an official institution of the member whose territories include Hong Kong, and that concrete provisions have been stipulated taking into account the specific circumstances of HKMA. My authorities will consent to HKMA's participation in the NAB under the terms and conditions set forth in the said Decision of the Board. As for specific issues regarding HKMA's participation, I would like to indicate that all provisions applied to HKMA under NAB should be consistent with its status as an official institution of the member whose territories cover Hong Kong. I appreciate the staff's clarification on this point.
>
> Finally, we hope NAB will be open to potential participants with the financial capacity to support the international monetary system based on the same terms.
>
> With these remarks, I can support the proposed decisions.

Mr. Pascual welcomed the creation of the NAB. In an increasingly globalized economy, the availability of resources under the NAB would be beneficial to all. Particularly noteworthy was the participation by a broad group of countries. Thus, the responsibility for the management of the international financial system would be shared by a larger number of countries. The agreement to hold annual meetings of the participants to review macroeconomic and financial market developments would enhance the crisis-preventive role of the NAB. At the same time, his chair agreed with other Directors that the NAB should not be considered a substitute for quota increases. The proposed decisions reflected the consensus reached by participants at their meetings in 1996, and his chair fully supported the decisions. He wished to note that his Spanish authorities were taking measures to enable Spain to adhere to the NAB.

Mr. Zamani, welcoming the discussion, stated that he had consulted with the authorities of the NAB participants in his constituency, namely, Malaysia, Singapore, and Thailand. The authorities had reviewed the staff paper and found its contents and the proposed decisions to be in accordance with the agreement reached during the NAB discussions in 1996. Accordingly, his chair supported the proposed decisions.

Mr. Andersen made the following statement:

> This chair welcomes the creation of the New Arrangements to Borrow, entailing availability of increased resources for the Fund, thereby improving the Fund's ability to meet requests for balance of payments assistance in exceptional circumstances where the stability of the international monetary system is at stake. We appreciate the participation of a number of new participants in these new arrangements and, as a representative of four of the architects, it may not come as a surprise when I say that I find the modalities of the arrangements to be well designed.
>
> However, the establishment of the NAB does not reduce the need for, nor must it delay, a general and, hopefully, substantial quota increase, in order to ensure that the Fund is equipped with adequate resources to carry out its basic functions.

With these remarks, I support the proposed decision.

The Chairman thanked Mr. Bernes for his role in establishing the NAB. Mr. Bernes had been the driving force behind the initiative and had seen it through its various stages, starting from the period before the Halifax Summit and continuing until the NAB had been agreed to by all the participants. He asked Mr. Autheman and Mr. Grilli to convey his thanks to Mr. Noyer and Mr. Draghi, respectively, for their efforts in creating the NAB.

Mr. Bernes made the following statement:

I am sure it comes as no surprise to know that we warmly welcome this discussion today and fully support the decisions before us.

We see this as an important event, both because, once implemented through the appropriate domestic procedures, it will ensure that the Fund has available a backstop to meet crises and because the broader range of participants is a recognition of the changing economic realities and is a new and important collaborative effort among all of the participants in the NAB.

I would like to thank all of those, including the Chairman, who have expressed thanks for my role in this. It was a unique opportunity for me. It is rare that one has the chance to see an initiative, particularly of this magnitude, through from the beginning to the end in the space of a little less than two years, which is quite fast given how international agreements usually proceed. But, as the Chairman noted, I was chair of a working group of the Group of Seven (G-7), which made this recommendation to the G-7 heads of government, and then through the Group of Ten; I was there during the discussions with the new participants; and, finally, I am fortunate enough to be here today to partake in this decision.

Clearly, any undertaking of this magnitude requires the support and efforts of a number of people, and many people have contributed to this. I would just like to mention three people in particular: Neil Hayden, from Australia, who played an important role in bringing the participants together, and, from the Fund staff, both the General Counsel and the Treasurer provided me with invaluable assistance during the process, and I would like also to thank them. This has consumed a large part of my life over the last two years. I look forward to new challenges.

Mr. Newman made the following statement:

I too would like to join other speakers in thanking all those who have had such an important role to play in bringing this initiative to this stage. I would caution Mr. Bernes, however, that this is not the end; this is only the beginning. He will now have an opportunity in the days ahead to implement what he has wrought, and maybe the hardest part is yet to come.

The NAB represents a milestone for the Fund in a number of respects. Like any insurance policy, we hope we never have to use it, but it is always nice to have, especially one that has been updated in this particular manner, not only substantially increasing the size but also modifying the provisions from those existing in the GAB to make it more user friendly, and I believe in part that will help respond to some of Mr. Leiva's concerns about the efficacy and the efficiency of its use. In the procedures we have incorporated in the NAB, there are several places in the provisions where there is considerably more flexibility than we had under the GAB, and this will help.

Equally important, and maybe even more important, is the addition of the new participants, which represents a recognition of a major change in the international monetary system over the past 20 years. We welcome the increased number of countries, for not only their financial contribution, but also their willingness to take greater responsibility for, and to participate in, the active management of the system that has benefited us all so greatly. We look forward to participating in the consultation arrangements that have been developed and that are reflected in the annex to this paper, in order to be able to get a better sense of the views of these countries on issues that will affect them and us all greatly in the years ahead.

With regard to the NAB itself, I would simply note that my authorities will be submitting their budget proposals in the next few weeks, and the NAB participation by the United States is an integral part of that. We hope to proceed expeditiously and to obtain early approval by the Congress of these arrangements.

Finally, I would simply reiterate the point that we have made before and that other speakers have made today. We do not view the NAB as an alternative to a quota increase, and we look forward to participating in our continuing discussions of the quota with a view to a successful agreement as early as possible.

Mr. Kiekens made the following statement:

I also am very glad to approve today the two proposed decisions. Like Mr. Newman, I agree that probably the most difficult part is still before us in order to implement this agreement and to complement it. I am very glad to note from Mr. Newman's statement that he is confident that the U.S. authorities will approve this proposal soon in the framework of the budgetary procedures, and also that he looks forward to a constructive dialogue and decision- making process on the quota increase. Indeed, like Mr. Newman, I also want to stress that the Fund's ability to fulfill its functions in the future also requires—in addition to these important arrangements—an increase in quotas.

I am very glad to welcome the new participants in this agreement, among them Luxembourg and Austria, from my constituency. When one looks closely at those new participants, one can observe that for many of them the divergence between their calculated quotas and their actual quotas is quite large. In this respect, I am willing to recall that during the negotiations on the NAB this element was recognized, and that in the framework of the quota discussions one should have a look at whether those members who are in a position to support the international financial system are not well suited for an ad hoc quota increase.

Mr. Shields made the following statement:

Like others, I very much welcome this agreement, and also would like to thank all those concerned, particularly, amongst those here, the staff members, the General Counsel and the Treasurer and, of course, Mr. Bernes, who was a driving force behind this.

As Mr. Bernes said, it may have seemed quite a long process, but compared with other international agreements it is really not that long. I hope that the participants will be able to carry through the relevant legislation or other matters as soon as possible so that we can put this into implementation as soon as we can this year.

One of the most important aspects of the NAB is the broadening of the participation. This is not only a question, as Mr. Newman said, of financial involvement; more importantly, it gives them a real share in the governance of the international financial system. This represents their growing power and involvement. It is just one aspect of what I hope will be a continuing trend. There are plenty of new participants this time. In the future, as well, there may be an opportunity to expand the membership further. Obviously, that is a matter for the long term, rather than the short term, but it is something that we could bear in mind. Among the new participants, obviously, a particularly warm welcome to the Hong Kong Monetary Authority (HKMA). I was glad for the clarification by the General Counsel on the status of the HKMA, which certainly fitted well with our understanding, and with Mr. Zhang's remarks regarding the consent of China. We very much welcome the Hong Kong Monetary Authority's involvement in this, and look forward to the full implementation of the NAB.

Mr. Mohammed, speaking on behalf of his Kuwait authorities, said that he welcomed the establishment of the NAB. He also wished to commend Mr. Bernes and the Fund staff for their work in setting up the NAB, and supported the proposed decisions.

Mr. Autheman stated that he welcomed the NAB and supported the proposed decisions. He wished to join other Directors in thanking Mr. Bernes for his work throughout the process. The NAB was an important achievement, because it would strengthen the capacity of the Fund to respond to unexpected crises. Also, the participation of a broader group of countries was a welcome development.

Mr. Grilli stated that his chair supported the proposed decisions. An important element that was necessary for the effective and orderly management of the international monetary system was being put in place. The creation of the NAB was evidence of the capacity of the system to adapt to changing circumstances and of the ability and willingness of members to participate actively and responsibly in the management of the system. That was good news and showed that the international monetary system was capable of adapting to changing circumstances. Like other Directors, he believed that the most lasting testimony of the effectiveness of the NAB would be if it never became necessary to call upon those resources, because that would be proof that the system was working well. Thus, the NAB were akin to an insurance policy involving exceptional resources. That did not imply that the ordinary resources of the Fund should not be enlarged and adapted as needed. However, with the NAB in place, it was now possible to look to the future with a sense of ease and the knowledge that the Fund was moving in the right direction.

Mr. Barro Chambrier commended the participants for their swift decision to establish the NAB. He wished, in particular, to thank Mr. Bernes and the Fund for that important achievement. His chair was pleased with the establishment of the NAB, because it would allow the Fund to have access to additional resources to respond to systemic crises. He supported the proposed decisions.

Miss John remarked that her chair was pleased with the new arrangements to augment the Fund's supplementary resources, which would allow the Fund to have access to a larger pool of resources if needed. Her chair would have liked more equal treatment of participants and nonparticipants under the NAB. Like other Directors, she agreed that every effort must be made to strengthen the Fund's own resources through the timely conclusion of the Eleventh General Review of Quotas. With those remarks, she supported the proposed decisions.

Mr. Vernikov made the following statement:

> I welcome the establishment of the New Arrangements to Borrow and endorse the proposed decisions.
>
> Among other features of the NAB, I would like to emphasize its increased number of participants as compared to the GAB. I noted with satisfaction that the draft Instrument does not rule out the participation of other members, when their financial situation allows for that.
>
> Let me also echo other speakers in the belief that, however important an undertaking the NAB might be, it should not substitute for nor hinder the ongoing work on the implementation of the Eleventh Review of Quotas. The Fund remains a quota-based Institution, so we should, first of all, look at the Institution's own resources in the assessment of its capability to deal with situations it might face and consider as threatening for the stability of the international monetary system.

Mr. Wijnholds stated that he welcomed the NAB and supported the proposed decisions. He agreed with his colleagues that it was an excellent initiative; particularly noteworthy was the participation by 25 countries. He was pleased to hear that there was a consensus among Directors that the NAB were not a substitute for a quota increase.

Mr. Disanayaka commented that he shared the views of other Directors; in particular he welcomed the participation of a broad range of countries. He wished to congratulate Mr. Bernes and others who had been involved in the establishment of the NAB, and joined other Directors in emphasizing that the NAB were not a substitute for a quota increase. Thus, he hoped that there would be progress on the quota discussions. With those remarks, he supported the proposed decisions.

Mr. Mirakhor commented that it would appear that the rules for the participation of new members were more stringent under the NAB than under the General Arrangements to Borrow. For instance, according to paragraph 3(b) of the proposed decision on the NAB, a request by a new member or institution to participate in the NAB would require the approval of the Fund and of participants representing 80 percent of total credit arrangements; by contrast, under paragraph 3(b) of the GAB, a member or institution could participate if the Fund agreed and no participant objected. He asked for the staff's clarification on the difference in treatment under the two arrangements.

The General Counsel observed that, under the GAB, there was a veto conferred on each participant, allowing it to oppose the adherence of new participants to the GAB. By contrast, under the NAB, it would be easier for a new member to participate at the time of the renewal of the arrangements, as only the consent of those members and institutions representing 80 percent of total credit arrangements was required.

Mr. Mirakhor noted that paragraph 9(a) of the proposed decision on the NAB stated: "The Fund shall pay interest on its indebtedness under this decision at a rate equal to the combined market interest rate computed by the Fund from time to time for the purpose of determining the rate at which it pays interest on holdings of special drawing rights or any such higher rate as may be agreed between the Fund and participants representing 80 percent of the total credit arrangements." He asked whether that provision implied that the borrowing country could be required to pay a surcharge on use of Fund resources in those cases in which the Fund would need to borrow under the NAB.

The Treasurer observed that, as stated on page 11 of the paper, a higher interest rate might be considered if the Fund decided to levy a surcharge on holdings of members' currencies exceeding a certain percentage of quota and purchases giving rise to those holdings were financed by borrowing under the NAB. The proceeds of the surcharge would then be paid to the NAB participants.

Mr. Mirakhor remarked that he was concerned because that provision appeared to imply that a surcharge might be levied on members for use of Fund resources when the Board itself had not taken a decision to that effect. He therefore welcomed the provisions under paragraph 10 of the proposed decision, because it assured him that the decisions under the NAB would not affect members' use of Fund resources, which would continue to be determined by the Fund's policies and practices. In that context, he wondered whether it might be useful to state explicitly that nothing in the decision on the NAB would affect charges for use of Fund resources by members.

The Chairman noted that paragraph 10 of the decision stated explicitly that, "Nothing in this decision shall affect the authority of the Fund with respect to requests for the use of its resources by individual members, and access to these resources by members shall be determined by the Fund's policies and practices, and shall not depend on whether the Fund can borrow under this decision." Thus, the authority of the Fund with respect to members' use of resources was, in fact, preserved.

The General Counsel confirmed that there was a complete separation between what the Fund charged members for use of its resources and what the Fund paid on its borrowing under the NAB.

Mr. Mirakhor said that he was satisfied by the explanations provided by the Chairman and the General Counsel.

Mr. Akatu stated that his chair welcomed the establishment of the NAB, which would enhance the Fund's ability to respond to systemic crises. He supported the proposed decisions.

The Chairman welcomed the creation of the NAB. As Mr. Newman had said, it was a milestone for the Fund. He wished to join Directors in expressing his gratitude to all those who had worked to make the NAB possible, particularly Mr. Bernes and the 25 countries that were participating in the NAB. The establishment of the NAB was indeed timely and reflected changing economic realities, especially the strengthened economic position of many members. The Fund was more secure and better equipped to respond to events that might threaten the stability of the international monetary system. The existence of the NAB, together with their efforts to strengthen surveillance, made him reasonably hopeful that, as was the experience with the GAB, it would not be necessary to activate the NAB for at least 18 years. There was a consensus among all members of the Board on the purpose of the NAB and the spirit in which it would be invoked. It was important to avoid moral hazard, and the Fund would continue to recommend that members pursue prudent macroeconomic policies. Members agreed on the importance of sound policies and that augured well for the future.

He was grateful to all those who had noted that the NAB were not a substitute for quota increases and hoped that a decision on quota increases could be reached as quickly as possible, the Chairman stated. He did not doubt that the same dynamism and driving force that had led to the timely creation of the NAB would also bring about an early conclusion to the discussions on the quota increases.

The Executive Board took the following decisions:

New Arrangements to Borrow—Establishment

Preamble

In order to enable the Fund to fulfill more effectively its role in the international monetary system, a number of countries with the financial capacity to support the international monetary system have agreed to make available to the Fund resources in the form of loans up to specified amounts when supplementary resources are needed to forestall or cope with an impairment of the international monetary system or to deal with an exceptional situation that poses a threat to the stability of that system. In order to give effect to these intentions, the following terms and conditions are adopted under Article VII, Section 1 of the Articles of Agreement.

Paragraph 1. Definitions

(a) As used in this decision the term:

(i) "amount of a credit arrangement" means the maximum amount expressed in special drawing rights that a participant undertakes to lend to the Fund under a credit arrangement;

(ii) "Articles" means the Articles of Agreement of the Fund;

(iii) "available commitment" means a participant's credit arrangement less any committed or drawn balances;

(iv) "borrowed currency" or "currency borrowed" means currency transferred to the Fund's account under a credit arrangement;

(v) "call" means a notice by the Fund to a participant to make a transfer under its credit arrangement to the Fund's account;

(vi) "credit arrangement" means an undertaking to lend to the Fund on the terms and conditions of this decision;

(vii) "currency actually convertible" means currency included in the Fund's quarterly operational budget for transfers;

(viii) "drawer" means a member that purchases borrowed currency from the Fund in an exchange transaction, including an exchange transaction under a stand-by or Extended Arrangement;

(ix) "indebtedness" of the Fund means the amount it is committed to repay under a credit arrangement;

(x) "member" means a member of the Fund;

(xi) "participant" means a participating member or a participating institution;

(xii) "participating institution" means an official institution of a member that has entered into a credit arrangement with the Fund with the consent of the member, or an official institution of a nonmember that has entered into a credit arrangement with the Fund;

(xiii) "participating member" means a member that has entered into a credit arrangement with the Fund.

(b) For the purposes of this decision, the Hong Kong Monetary Authority (HKMA) shall be regarded as an official institution of the member whose territories include Hong Kong, provided that:

(i) loans by the HKMA and payments by the Fund to the HKMA under this decision shall be made in principle in the currency of the United States of America, unless the currency of another member is agreed between the Fund and the HKMA;

(ii) the participation of the HKMA shall not give rise to the application of paragraph 6 A to the member whose territories include Hong Kong; and

(iii) the references to the balance of payments and reserve position in paragraphs 7 A(c), 7 B(b) and 11(e) shall be understood to refer to the balance of payments and reserve position of Hong Kong.

Paragraph 2. Credit Arrangements

(a) A member or institution that adheres to this decision undertakes to make loans to the Fund on the terms and conditions of this decision up to the amount in special drawing rights set forth in the Annex to this decision or established in accordance with paragraph 3(b).

(b) Unless otherwise agreed with the Fund, loans under this decision shall be made in the currency of the participant. If the participant is an institution of a nonmember, the Fund and the participant shall agree on which member's currency or members' currencies shall be used for the loans. Agreements under this paragraph shall be subject to the concurrence of any member whose currency shall be used in the loans.

Paragraph 3. Adherence

(a) Any member or institution specified in the Annex may adhere to this decision in accordance with paragraph 3(c).

(b) Any member or institution not specified in the Annex, including an institution of a nonmember, may apply to become a participant at the time of renewal of this decision in accordance with paragraph 19. Any such member or institution that wishes to become a participant shall, after consultation with the Fund, give notice of its willingness to adhere to this decision, and, if the Fund and participants representing 80 percent of total credit arrangements under the renewed decision shall so agree, the member or institution may adhere in accordance with paragraph 3(c). When giving notice of its willingness to adhere under this paragraph 3(b), a member or institution shall specify the amount, expressed in special drawing rights, of the credit arrangement which it is willing to enter into, provided that the amount shall not be less than the credit arrangement of the participant with the smallest credit arrangement. The admission of a new participant shall lead to a proportional reduction in the credit arrangements of all existing participants whose credit arrangements are above that of the participant with the smallest credit arrangement: such proportional reduction in the credit arrangements of participants shall be in an aggregate amount equal to the amount of the new participant's credit arrangement less any increase in total credit arrangements decided in accordance with paragraph 5(a), provided that no participant's credit arrangement shall be reduced below the minimum amount set out in the Annex.

(c) A member or institution shall adhere to this decision by depositing with the Fund an instrument setting forth that it has adhered in accordance with its law and has taken all steps necessary to enable it to carry out the terms and conditions of this decision. On the deposit of the instrument the member or institution shall be a participant as of the date of the deposit or of the effective date of this decision, whichever is later.

Paragraph 4. Entry into Force

This decision shall become effective when it has been adhered to by members or institutions included in the Annex with credit arrangements amounting to not less than SDR 28.9 billion, including the five members or institutions with the largest credit arrangements specified in the Annex.

Paragraph 5. Changes in Amounts of Credit Arrangements

(a) When a member or institution is authorized under paragraph 3(b) to adhere to this decision, the total amount of credit arrangements may be increased by the Fund with the agreement of participants representing 85 percent of total credit arrangements; the increase shall not exceed the amount of the new participant's credit arrangement.

(b) The amounts of participants' individual credit arrangements may be reviewed from time to time in the light of developing circumstances and changed with the agreement of the Fund and of participants representing 85 percent of total credit arrangements, including each participant whose credit arrangement is changed. This provision may be amended only with the consent of all participants.

Paragraph 6. Initiation of Procedure

A. Participants

When a participating member or a member whose institution is a participant approaches the Fund on an exchange transaction or a stand-by or Extended Arrangement and the Managing Director, after consultation, considers that the exchange transaction or stand-by or Extended Arrangement is necessary in order to forestall or cope with an impairment of the international monetary system, and that the Fund's resources need to be supplemented for this purpose, the Managing Director may initiate the procedure set out in paragraph 7A.

B. Nonparticipants

The Managing Director may initiate the procedure set out in paragraph 7A for exchange transactions requested by members that are not participants if (a), the exchange transactions are (i) transactions in the upper credit tranches, (ii) transactions under Stand-By Arrangements extending beyond the first credit tranche, (iii) transactions under Extended Arrangements, or (iv) transactions in the first credit tranche in conjunction with a Stand-By Arrangement or an Extended Arrangement, and (b), after consultation, the Managing Director considers that the Fund's resources need to be supplemented to meet actual and expected requests for financing that reflect the existence of an exceptional situation associated with balance of payments problems of members of a character or aggregate size that could threaten the stability of the international monetary system. In making proposals for calls pursuant to paragraph 6B, the Managing Director shall pay due regard to potential calls pursuant to paragraph 6A.

Paragraph 7. Proposals and Calls

A. Proposals

(a) The Managing Director shall make a proposal for calls under this decision only after consultation with Executive Directors and participants.

(b) In making a proposal for resources to be lent to the Fund, the Managing Director shall identify the prospective drawer, the amount, and the period during which the resources requested in the proposal may be called.

(c) If a participant determines that it will not be able to meet calls under a proposal because of its present and prospective balance of payments and reserve position, which would normally be reflected in the member's exclusion from the list of countries that are included in the Fund's quarterly operational budget for transfers of their currencies, it shall so notify the Fund and the other participants. If the participant is an institution of a nonmember, the participant shall consult with the Fund on that nonmember's balance of payments and reserve position before making a determination under this provision. A participant shall exercise restraint and shall take into account the views of the Fund and other participants in making such a determination.

(d) Unless otherwise specified under paragraph 7A(e), a proposal shall be for calls proportional to the amount of each participant's credit arrangement.

(e) The Managing Director may make a proposal for calls that are not proportional to the amount of each participant's credit arrangement under the following circumstances:

(i) If proportional calls sufficient to provide the total amount sought from participants to finance the proposed exchange transactions cannot be made because at least one participant's available commitment is insufficient to meet such a proportional call, the Managing Director may ask every participant whose available commitment would have been sufficient to meet fully such a proportional call to provide the amount under such a proportional call; provided that, if the Managing Director asks every such participant to provide such amount, the Managing Director shall also ask every participant whose available commitment would have been insufficient to meet such a proportional call to provide an amount to the extent of its available commitment. If necessary, the Managing Director may also ask for an amount in addition to that provided under the prior sentence from a participant whose available commitment exceeds the amount it would provide under such a proportional call.

(ii) If proportional calls sufficient to provide the total amount sought from participants to finance the proposed exchange transactions cannot be made because at least one participant lacks sufficient amounts of the type of currency or currencies needed for the proposed exchange transactions, the Managing Director may ask every participant that is in a position to provide the currency or currencies needed to provide the amount under such a proportional call, up to the amount of its available commitment or the amount that it is in a position to provide, whichever is less. If necessary, the Managing Director may also ask a participant whose available commitment exceeds the resources it would provide under such a proportional call and that remains in a position to provide the type of currency or currencies needed to provide an amount of the currency or currencies needed in addition to that provided under the prior sentence.

(f) The concurrence of every participant that would undertake to provide proportionately more resources than at least one other participant shall be required before the proposal can be accepted under Paragraph 7A(g).

(g) If there is not unanimity among the participants, the question whether the participants are prepared to facilitate, by making loans to the Fund, the exchange transactions or stand-by or Extended Arrangement specified in the proposal will be decided by a poll of the participants. A favorable decision shall require an 80 percent majority of total credit arrangements of participants eligible to vote. The decision shall be notified to the Fund.

(h) Neither the prospective drawer nor its participating institution nor participants that have notified that they will not meet calls under a proposal shall be eligible to vote on the proposal.

(i) A proposal shall become effective only if it is accepted by participants pursuant to paragraph 7A(g) and is then approved by the Executive Board.

(j) After a proposal has been accepted, commitments and drawings shall not be affected by a subsequent change in the amounts of the credit arrangements.

B. Calls

(a) Unless otherwise provided in a proposal for future calls approved under paragraph 7A, each call shall be made in proportion to the amounts in the proposal.

(b) Except with the participant's consent, calls may not be made on a participant, on which calls could otherwise be made pursuant to this paragraph, when, based on its present and prospective balance of payments and reserve position, the member is not included and is not being proposed by the Managing Director to be included in the list of countries in the quarterly operational budget for transfers of its currency. If the participant is an institution of a nonmember, its ability to meet calls under this decision shall be determined by the Fund, after consultation with the participant, on the basis of that nonmember's present and prospective balance of payments and reserve position. In the event that a call is not made on a participant, the Managing Director may propose to the other participants that substitute amounts be made available under their credit arrangements, and this proposal shall be subject to the procedure of paragraph 7A.

(c) When the Fund makes a call pursuant to this paragraph, the participant shall promptly make the transfer in accordance with the call.

Paragraph 8. Evidence of Indebtedness

(a) The Fund shall issue to a participant, on its request, nonnegotiable instruments evidencing the Fund's indebtedness to the participant. The form of the instruments shall be agreed between the Fund and the participant.

(b) Upon repayment of the amount of any instrument issued under paragraph 8(a) and all accrued interest, the instrument shall be returned to the Fund for cancellation. If less than the amount of any such instrument is repaid, the instrument shall be returned to the Fund and a new instrument for the remainder of the amount shall be substituted with the same maturity date as in the old instrument.

Paragraph 9. Interest

(a) The Fund shall pay interest on its indebtedness under this decision at a rate equal to the combined market interest rate computed by the Fund from time to time for the purpose of determining the rate at which it pays interest on holdings of special drawing rights or any such higher rate as may be agreed between the Fund and participants representing 80 percent of the total credit arrangements.

(b) A change in the method of calculating the combined market interest rate shall apply to the Fund's indebtedness under this decision only if the Fund and participants representing 80 percent of the total credit arrangements so agree; provided that, if a participant so requests at the time this agreement is reached, the change shall not apply to the Fund's indebtedness to that participant outstanding at the date the change becomes effective.

(c) Interest shall accrue daily and shall be paid as soon as possible after each July 31, October 31, January 31, and April 30.

(d) Interest due to a participant shall be paid, as determined by the Fund in consultation with the participant, in special drawing rights, in the participant's currency, in the currency borrowed, or in other currencies that are actually convertible.

Paragraph 10. Use of Borrowed Currency

The Fund's policies and practices under Article V, Sections 3 and 7 on the use of its general resources and Stand-By Arrangements and Extended Arrangements, including those relating to the period of use, shall apply to purchases of currency borrowed by the Fund. Nothing in this decision shall affect the authority of the Fund with respect to requests for the use of its resources by individual members, and access to these resources by members shall be determined by the Fund's policies and practices, and shall not depend on whether the Fund can borrow under this decision.

Paragraph 11. Repayment by the Fund

(a) Subject to the other provisions of this paragraph 11, the Fund, five years after a transfer by a participant, shall repay the participant an amount equivalent to the transfer calculated in accordance with paragraph 12. If the drawer for whose purchase participants make transfers is committed to repurchase at a fixed date earlier than five years after its purchase, the Fund shall repay the participants at that date. Repayment under this paragraph 11(a) or under paragraph 11(c) shall be, as determined by the Fund, in the currency borrowed whenever feasible, in the currency of the participant, in special drawing rights in an amount that does not increase the participant's holdings of special drawing rights above the limit under Article XIX, Section 4, of the Articles of Agreement unless the participant agrees to accept special drawing rights above that limit in such repayment, or, after consultation with the participant, in other currencies that are actually convertible. Repayments to a participant under paragraph 11(b) and 11(e) shall be credited against transfers by the participant for a drawer's purchases in the order in which repayment must be made under this paragraph 11(a).

(b) Before the date prescribed in paragraph 11(a), the Fund, after consultation with the participants, may make repayment in part or in full to one or several participants. The Fund shall have the option to make repayment under this paragraph 11(b) in the participant's currency, in the currency borrowed, in special drawing rights in an amount that does not increase the participant's holdings of special drawing rights above the limit under Article XIX, Section 4, of the Articles of Agreement unless the participant agrees to accept special drawing rights above that limit in such repayment, or, with the agreement of the participant, in other currencies that are actually convertible.

(c) Whenever a reduction in the Fund's holdings of a drawer's currency is attributed to a purchase of currency borrowed under this decision, the Fund shall promptly repay an equivalent amount. If the Fund is indebted to a participant as a result of transfers to finance a reserve tranche purchase by a drawer and the Fund's holdings of the drawer's currency that are not subject to repurchase are reduced as a result of net sales of that currency during a quarterly period covered by an operational budget, the Fund shall repay at the beginning of the next quarterly period an amount equivalent to that reduction, up to the amount of the indebtedness to the participant.

(d) Repayment under paragraph 11(c) shall be made in proportion to the Fund's indebtedness to the participants that made transfers in respect of which repayment is being made.

(e) Before the date prescribed in paragraph 11(a), a participant may give notice representing that there is a balance of payments need for repayment of part or all of the Fund's indebtedness and requesting such repayment. If a reversal of its loan may lead to further loans to the Fund by other participants, the participant seeking such reversal shall consult with the Managing Director and with the other participants before giving notice. The Fund shall give the overwhelming benefit of any doubt to the participant's representation. Repayment shall be made after consultation with the participant in the currencies of other members that are actually convertible, or in special drawing rights, as determined by the Fund. If the Fund's holdings of currencies in which repayment should be made are not wholly adequate, individual participants may be requested to provide the necessary balance under their credit arrangements subject to the limit of their available commitments. For all of the purposes of this paragraph 11, transfers under this paragraph 11(e) shall be deemed to have been made at the same time and for the same purchases as the transfers by the participant obtaining repayment under this paragraph 11(e).

(f) When a repayment is made to a participant, the amount that can be called for under its credit arrangement in accordance with this decision shall be restored pro tanto.

(g) The Fund shall be deemed to have discharged its obligations to a participating institution to make repayment in accordance with the provisions of this paragraph or to pay interest in accordance with the provisions of paragraph 9 if the Fund transfers an equivalent amount in special drawing rights to the member in which the institution is established.

Paragraph 12. Rates of Exchange

(a) The value of any transfer shall be calculated as of the date of the dispatch of the instructions for the transfer. The calculation shall be made in terms of the special drawing right in accordance with Article XIX, Section *7(a)* of the Articles, and the Fund shall be obliged to repay an equivalent value.

(b) For all of the purposes of this decision, the value of a currency in terms of the special drawing right shall be calculated by the Fund in accordance with Rule 0-2 of the Fund's Rules and Regulations.

Paragraph 13. Transferability

A participant may not transfer all or part of its claim to repayment under a credit arrangement except with the prior consent of the Fund and on such terms and conditions as the Fund may approve.

Paragraph 14. Notices

Notice to or by a participating member under this decision shall be in writing or by rapid means of communication and shall be given to or by the fiscal agency of the participating member designated in accordance with Article V, Section 1 of the Articles and Rule G-1 of the Rules and Regulations of the Fund. Notice to or by a participating institution shall be in writing or by rapid means of communication and shall be given to or by the participating institution.

Paragraph 15. Amendment

(a) Except as provided in paragraphs 5(b), 15(b) and 16, this decision may be amended during the period prescribed in paragraph 19(a) and any subsequent renewal periods that may be decided pursuant to paragraph 19(b) only by a decision of the Fund and with the concurrence of participants representing 85 percent of total credit arrangements. Such concurrence shall not be necessary for the modification of the decision on its renewal pursuant to paragraph 19(b).

(b) If in its view an amendment materially affects the interest of a participant that voted against the amendment, the participant shall have the right to withdraw its adherence to this decision by giving notice to the Fund and the other participants within 90 days from the date the amendment was adopted. This provision may be amended only with the consent of all participants.

Paragraph 16. Withdrawal of Adherence

Without prejudice to paragraph 15(b), a participant may withdraw its adherence to this decision in accordance with paragraph 19(b) but may not withdraw within the period prescribed in paragraph 19(a) except with the agreement of the Fund and all participants. This provision may be amended only with the consent of all participants.

Paragraph 17. Withdrawal from Membership

If a participating member or a member whose institution is a participant withdraws from membership in the Fund, the participant's credit arrangement shall cease at the same time as the withdrawal takes effect. The Fund's indebtedness under the credit arrangement shall be treated as an amount due from the Fund for the purpose of Article XXVI, Section 3, and Schedule J of the Articles.

Paragraph 18. Suspension of Exchange Transactions and Liquidation

(a) The right of the Fund to make calls under paragraph 7 and the obligation to make repayments under paragraph 11 shall be suspended during any suspension of exchange transactions under Article XXVII of the Articles.

(b) In the event of liquidation of the Fund, credit arrangements shall cease and the Fund's indebtedness shall constitute liabilities under Schedule K of the Articles. For the purpose of paragraph 1(a) of Schedule K, the currency in which the liability of the Fund shall be payable shall be first the currency borrowed, then the participant's currency and finally the currency of the drawer for whose purchases transfers were made by the participants.

Paragraph 19. Period and Renewal

(a) This decision shall continue in existence for five years from its effective date. When considering a renewal of this decision for the period following the five-year period referred to in this paragraph 19(a), the Fund and the participants shall review the functioning of this decision and shall consult on any possible modifications.

(b) This decision may be renewed for such period or periods and with such modifications, subject to paragraphs 5(b), 15(b) and 16, as the Fund may decide. The Fund shall adopt a decision on renewal and modification, if any, not later than twelve months before the end of the period prescribed in paragraph 19(a). Any participant may advise the Fund not less than six months before the end of the period prescribed in paragraph 19(a) that it will withdraw its adherence to the decision as renewed. In the absence of such notice, a participant shall be deemed to continue to adhere to the decision as renewed. Withdrawal of adherence in accordance with this paragraph 19(b) by a participant, whether or not included in the Annex, shall not preclude its subsequent adherence in accordance with paragraph 3(b).

(c) If this decision is terminated or not renewed, paragraphs 8 through 14, 17 and 18(b) shall nevertheless continue to apply in connection with any indebtedness of the Fund under credit arrangements in existence at the date of the termination or expiration of the decision until repayment is completed. If a participant withdraws its adherence to this decision in accordance with paragraph 15(b), paragraph 16, or paragraph 19(b), it shall cease to be a participant under the decision, but paragraphs 8 through 14, 17 and 18(b) of the decision as of the date of the withdrawal shall nevertheless continue to apply to any indebtedness of the Fund under the former credit arrangement until repayment has been completed.

Paragraph 20. Interpretation

Any question of interpretation raised in connection with this decision which does not fall within the purview of Article XXIX of the Articles shall be settled to the mutual satisfaction of the Fund, the participant raising the question, and all other participants. For the purpose of this paragraph 20 participants shall be deemed to include those former participants to which paragraphs 8 through 14, 17 and 18(b) continue to apply pursuant to paragraph 19(c) to the extent that any such former participant is affected by a question of interpretation that is raised.

Paragraph 21. Relationship with the General Arrangements to Borrow and Associated Borrowing Arrangements

(a) When considering whether to activate the New Arrangements to Borrow or the General Arrangements to Borrow, the Fund shall be guided by the following principles: The New Arrangements to Borrow shall be the facility of first and principal recourse except that:

(i) in the event of a request for a drawing on the Fund by a participating member, or a member whose institution is a participant, in both the General Arrangements to Borrow and the New Arrangements to Borrow, a proposal for calls may be made under either of the arrangements; and

(ii) in the event that a proposal for calls under the New Arrangements to Borrow is not accepted under paragraph 7A, a proposal for calls may be made under the General Arrangements to Borrow.

(b) Outstanding drawings and commitments under the New Arrangements to Borrow and the General Arrangements to Borrow shall not exceed SDR 34 billion, or such other amount of total credit arrangements as may be in effect in accordance with this decision. The available commitment of a participant under the New Arrangements to Borrow shall be reduced pro tanto by any outstanding drawings on, and commitments of, the participant under the General Arrangements to Borrow. The available commitment of a participant under the General Arrangements to Borrow shall be reduced pro tanto by the extent to which its credit arrangement under the General Arrangements to Borrow exceeds its available commitment under the New Arrangements to Borrow.

(c) References to drawings and commitments under the General Arrangements to Borrow shall include drawings and commitments under the Associated Borrowing Arrangements referred to in paragraph 23 of the General Arrangements to Borrow.

Paragraph 22. Other Borrowing Arrangements

Nothing in this decision shall preclude the Fund from entering into any other types of borrowing arrangements.

Decision No. 11428-(97/6), adopted
January 27, 1997

Annex
Participants and Amount of Credit Arrangements

The size of each participant's credit arrangement listed below has initially been based in principle on its relative economic strength as reflected in its quota in the Fund. Credit arrangements are subject to a minimum of SDR 340 million. Amounts have been adjusted between some participants subject to the condition that the total for the participants involved in an adjustment does not change and the minimum is observed. The amounts, in terms of SDRs of the individual credit arrangements and their total will remain in effect unless and until changed in accordance with this decision.

The size of the Hong Kong Monetary Authority's (HKMA) credit arrangement has not been calculated on the basis of the quota of the member whose territories include Hong Kong. The same principle explains the special provision on activation of the New Arrangements to Borrow to meet requests from such member.

Participant	Amount in Millions of Special Drawing Rights
Australia	810
Austria	412
Belgium	967
Canada	1396
Denmark	371
Deutsche Bundesbank	3557
Finland	340
France	2577
Hong Kong Monetary Authority	340
Italy	1772
Japan	3557
Korea	340
Kuwait	345
Luxembourg	340
Malaysia	340
Netherlands	1316
Norway	383
Saudi Arabia	1780
Singapore	340
Spain	672
Sveriges Riksbank	859
Swiss National Bank	1557

Thailand	340
United Kingdom of Great Britain and Northern Ireland	2577
United States of America	6712

New Arrangements to Borrow—Transferability of Claims

Pursuant to paragraph 13 of the New Arrangements to Borrow (NAB), the Fund consents in advance to the transfer of outstanding claims to repayments under the NAB on the terms and conditions set out below:

1. All or part of any claim under the NAB may be transferred at any time to a participant in the NAB.

2. As from the value date of the transfer, the transferred claim shall be held by the transferee on the same terms and conditions as claims originating under its credit arrangement, except that the transferee shall acquire the right to request early repayment of the transferred claim on balance of payments grounds pursuant to paragraph 11(e) of the NAB only if, at the time of the transfer, (i) the transferee is a member, or the institution of a member, whose balance of payment and reserve position is considered sufficiently strong for its currency to be usable in net transfers in the Fund's operational budget; or (ii) the transferee is the institution of a nonmember, and the balance of payments and reserve position of the nonmember is, in the opinion of the Fund, sufficiently strong to justify such acquisition.

3. The price for the claim transferred shall be as agreed between the transferee and the transferor.

4. The transferor of a claim shall inform the Fund promptly of the claim that is being transferred, the name of the transferee, the amount of the claim that is being transferred, the agreed price for transfer of the claim, and the value date of the transfer.

5. The transfer shall be registered by the Fund if it is in accordance with the terms and conditions of this decision. The transfer shall be effective as of the value date agreed between the transferee and the transferor.

6. If all or part of a claim is transferred during a quarterly period as described in paragraph 9(c) of the NAB, the Fund shall pay interest to the transferee on the amount of the claim transferred for the whole of that period.

7. If requested, the Fund shall assist in seeking to arrange transfers.

8. This decision shall become effective on the date of effectiveness of the NAB.

Decision No. 11429-(97/6), adopted
January 27, 1997

2. TONGA—1996 ARTICLE IV CONSULTATION

The Executive Directors considered the staff report for the 1996 Article IV consultation with Tonga (SM/97/4, 1/13/97; and Cor. 1, 1/15/97). They also had before them a background paper on recent economic developments in Tonga (SM/97/9, 1/14/97).

Mr. Zamani made the following statement:

> The Kingdom of Tonga, no doubt shares many of the economic constraints that Pacific Islands of similar location, size and resources face today. Economic growth decreased to its long-term average level of 1–2 percent per year as the dominant squash crop continues its declining trend due to obstacles of drought, marketing problems and competition. Whereas recent data show declining growth, Tonga's average growth in GDP per capita for 1985–94 ranks Tonga as attaining the highest per capita growth compared to neighboring Pacific Island economies. With a high GDP per capita primarily based on imports, the declining squash export has lead to a reduction in the foreign reserves of the kingdom. However, levels have not breached the benchmark of three months import coverage that the authorities have established as an internal safety boundary. They have stepped up efforts to revive exports, slow imports, and increase economic growth.
>
> The Chairman's summing up of the Executive Board discussion at the conclusion of the 1995 Article IV consultation mission indicated that Directors encouraged the need to strengthen and to reduce excess aggregate demand pressures. They welcomed the restrain on private sector credit, but cautioned that direct controls may undo the benefits of banking liberalization. Directors stressed fiscal restraint through minimization of planned salary increase by continuing the privatization policies
>
> As identified in the staff report, Tonga's external performance has been disappointing. Although Tonga's external sector has been known to rely on transfers as the balancing item in the Balance of Payments, the favorable squash export receipts gave the authorities confidence to expand Monetary and Fiscal policies. However, in 1993/94 the decline in the squash export aided by the expansionary monetary and fiscal policies caused the current account balance to decrease from a surplus of $3.8 million achieved in 1992/93 to a deficit of $4.7 million in 1995/96. The staff and the authorities have recognized the deteriorating external sector and have focused efforts in adjusting the Structural, Fiscal and Monetary policies of the Kingdom.
>
> The authorities recognize that the Private sector will be more efficient in leading the diversification of the agricultural sector and to provide the major impetus to economic growth. In the meantime, foreign direct investment has been facilitated to engage in value-added activities in the agro- and marine intermediate processing and the tourism sectors. Therefore authorities continue to pursue policies to foster the development of a viable private sector through the provision of a more favorable macroeconomic environment.

To ensure further progress in the liberalization of the economy, the authorities have prepared legislation to improve the legal framework for business and investment. Trade and labor practices legislation have also been contemplated. A number of price control measures have been revoked, and those few that remained are generally needed to safeguard public interest because of the lack of competition.

The focus on corporatizing government operations is still on going although problems associated with the current public enterprises identified in the staff report has slowed the downsizing pace. This is not to say that the government has abandoned the exercise, only that it is more cautious in the steps it is taking until current problems associated with public enterprises are rectified. However, a number of commercial activities operated by the government have been placed in the development budget in preparation for their eventual commercialization, corporatization, and privatization. Some good progress has been made in this area, despite the scarcity of local entrepreneurs with adequate financial backing and the shortage of skill human resources for management.

Budget surplus continues to be the aim of authorities as the external sector remains weak. The Ministry of Finance has recognized the need for a more efficient system of budgeting and production of sound statistics for policy formulation. Hence the authorities with assistance from the Asian Development Bank are currently designing a Program Performance Budget (PPB) system. The system is in the process of recoding the line item budget to better accommodate the needs of the PPB and the computerization of government accounts. It is also hopeful that the new system will accommodate the needs for the production of government Finance Statistics (GFS) that will better aid policy formulation. The authorities are now concentrating on improving the tax administration system to raise revenue. Revenue raising departments are in the preliminary stages of being fully computerized to enhance efficiency. The government also has stepped up efforts to patch up current loopholes in the present tariff schedule. A committee initiated by the Ministry of Finance has been set up to try and introduce a transition of the present customs tariff schedule into the Pacific Harmonized Customs tariff schedule originally formulated by the United nations. In the meantime, the rule for the provision of industrial incentives is being tightened to achieve higher cost effectiveness. An ongoing review on expenditure is looking into the issue of cost recovery in a number of public sector operations and the imposition of user fees in some government services. The authorities freezing of permanent civil service positions to contain the total wage bill to a nominal annual increase is envisaged to continue in the next financial year.

The authorities recognize the weak balance sheet of the National Reserve Bank of Tonga (NRBT) reduces its capacity to successfully implement indirect monetary control. The continuance of tight expenditure control conducted by the management of the NRBT is deemed favorable . This will aid the efforts to further tighten the monetary policies and decrease the flow of foreign exchange reserves. The interest rate policy aimed at protecting the country's international reserve, as well as to ensure the maintenance of a real positive interest rate continues to be favorable in real terms.

The authorities remain comfortable with the present framework and the operation of the exchange rate policy. The policy primarily is aimed to reduce short term volatility and to support a sustainable current account balance, while minimizing imported inflationary pressure.

Finally, on behalf of the Tongan authorities I would like to thank the staff for a concise and well written paper. The comments made by staff in the report and during the recent Article IV discussions, continue to be constructive and most helpful to the Tongan authorities. Moreover the Tongan authorities extend their sincere appreciation to the Fund in the efforts it has made over the years to help develop a sound macroeconomic environment for the small Pacific island member countries. The authorities of the Kingdom of Tonga once again look forward to hear the constructive suggestions the executive board may have in helping them arrest the current problems that hinder economic growth.

Ms. Turner-Huggins made the following statement:

Let me thank the staff for the frankness in their concise papers and Mr. Zamani for his useful statement, assuring us that the authorities "look forward to hear the constructive suggestions that the Executive Board may have in helping them arrest the current problems." This is encouraging against the backdrop of the recent downturn in the economy and the rather grim medium term outlook as estimated by staff. While the authorities, according to Mr. Zamani, "remain comfortable with the present framework"of their exchange rate policy, we are concerned that the current mix of policies will deliver meager and unfavorable results: real growth is estimated to grow by only 1–1.5 percent by the year 2000, a deterioration in the external current account deficit to around 4 percent of GDP is projected, along with considerable worsening in all of the debt indicators as the fiscal deficit widens over this period.

We share the staff's concerns regarding these trends and agree that there is need for timely, corrective action and a forward looking approach. First, let me say that most of the staff's advice rings familiar to last year's discussion which highlighted the need for fiscal restraint, monetary tightening, central bank strengthening and economic diversification. We also recall the emphasis put on speeding up implementation of reforms and making effective use of the ample supply of technical assistance. The Tongan authorities have been blessed in the past with relatively good squash harvest to support export growth and in general, economic and social problems have not been out of control, external grants have managed to fill financing gaps and the donor community (including the Fund) has been supportive in many areas of technical assistance. The population, which boasts a 100-literacy rate, remains small and emigration has served a useful valve to relieve social pressures. However, the decline in output last year and the prospects of no growth in fiscal year 1996/97 are cause for concern. Business as usual is probably not the prudent approach, and we urge the authorities to carefully examine the staff's policy suggestions and begin to take bold steps to implement reforms in a number of areas, including reducing the role of government in the economy.

On the fiscal position, we welcome along with staff, the authorities' adoption of three quantitative limits in the 1996/97 budget relating to recurrent spending, total public sector debt and debt service. However, as the staff rightly point out, the weakness in the fiscal position cannot be addressed durably in this fashion. A more structural approach to fiscal consolidation is necessary. In particular, there is a need to address the financial viability of the public enterprise sector and to have a true assessment of its financial condition. In the absence of this information, the authorities may be underestimating the extent of the fiscal impulse and as such are unable to assess its contribution to demand pressures. The measurement of the fiscal deficit should also include the unfunded liabilities due to the noncontributory nature of the pension scheme, and the authorities are again urged to consider changing the nature of the scheme to include employee contributions. I would appreciate the staff's comment on the authorities' approach to dealing with the public enterprises as summed up in footnote 16, page 19 of the background paper on recent economic developments, which articulated the view that services/goods in the public sector are not costed such that prices reflect their true cost of production and that public commercial activities pose unfair competition for the private sector.

We agree with the staff's suggestions regarding broadening the tax base. In particular, we would encourage the authorities to abandon the Industrial Incentives Act which is not only costly to the budget in terms of lost income tax revenue but remains rife with discriminatory practices. A more transparent, rules-based incentive system is warranted. The staff's call for tax reform to lessen the dependence on trade taxes, and to make the tax system conducive to business activity should be taken seriously as Tonga seeks to expand growth, broaden its investment base, improve the investment climate and attract foreign investors.

On the banking system—while there is growing awareness that a prudential framework by itself is not a panacea for a sound banking system, it is certainly a necessary condition. A packaged approach to the banking system is crucial which should include some "vision" by the authorities of what the banking system should be—hopefully this will include a strong supervisory and prudential framework; an institutionally capable and financially viable central bank; and other supporting institutional arrangements (including a judicial framework). As such, it is imperative that legislation be passed to give the central bank authority to issue adequate prudential regulations (to include the collection of timely and accurate financial data from banks). These issues should be viewed within the context of continued likely recession in Tonga with its impact on banks' loan portfolios and on the central bank's ability to carry out effective monetary policy.

To conclude, let me wish the Tongan authorities well in their difficult endeavors ahead and urge them not to delay in responding to the policy advice that is before them. We hope that they do indeed find these discussions "constructive"and we look forward to hearing of their progress during the coming year.

Mr. Ogushi made the following statement:

As the previous speaker has covered most of the important points, I shall be brief.

An increase in the fiscal deficit and in inflation are matters of concern. On the fiscal front, efforts are needed to reduce the deficit through expenditure control and expansion of the tax base to include the public enterprises. On inflation, a continued active role by the National Reserve Bank of Tonga, especially through improvement of indirect monetary policy, is expected. Eliminating the deficit of the National Reserve Bank is crucial to improving its functions.

With regard to the banking system, although staff are optimistic that there is no potential danger of a banking crisis, banking supervision should be strengthened at an early stage.

As I pointed out, there are many issues that remain to be tackled in the area of tax and banking system reform. In this connection, the Pacific Financial Technical Assistance Center (PFTAC), to which the Fund has been making a tremendous contribution, and which has a good reputation, should be utilized fully.

Tourism is a key to the sustainable growth of Tonga. With regard to structural policy, it will be important to improve the investment environment.

With these remarks, I wish the authorities further success.

Mr. Yakub made the following statement:

I would tend to agree with staff's assessment on the whole. The low economic growth rate poses a major challenge for the authorities, given the vulnerability to external shocks and the low factor endowments of this small, open island economy. While the scope for achieving higher growth exists, the way forward will inevitably require a dramatic change in policy approach, whereby the government would have to consider reducing its involvement in the productive side of the economy and create the business environment that will entice the private sector to take a more active role in economic development, with the appropriate checks and balances in place so as to avoid discrimination and malpractices. Ideally, I would like to see a situation where the government is gradually downsized over a reasonable time frame and its role be enhanced to that of a catalyst in promoting trade.

Having said this, I do realize that when viewed on a global scale, the relative success or failure of Tonga is very much related to its geographical location, as with other similar island states in the Pacific and in the Indian

Ocean and perhaps, to a lesser extent, the Caribbean. The small states of Europe (Luxembourg, Monaco, San Marino, Jersey, and Guernsey, etc) have clearly benefited from their proximity to larger states such as France, Germany, Italy and the United Kingdom. Singapore has benefited from its geographical location as an entrepot. By contrast, the Kingdom of Tonga in the Pacific is seriously affected by the long distances to neighboring continents or larger states. The way I see it, Tonga requires proportionately more social overhead capital than a larger state, which is able to benefit from economies of scale in the provision of ports, airports, roads, health care etc.

Tonga has also experienced a brain drain or large-scale emigration, especially in the 1970s and 1980s, despite the high birth rate. The scarcity of human capital, owing to its small population, pose a serious weakness in the running of the economy. As such, it is probable that Tonga has been unable to attain a "critical mass" in certain skills. In fact, the staff quite rightly identifies the limited human and financial resources as significant weaknesses under Statistical Issues in Annex V of the report.

With agriculture dominating the economy and accounting for 32 percent of GDP, it is reassuring to note from Mr. Zamani's statement that the authorities recognize the positive contribution that agricultural diversification will have on economic growth in the real sector. However one much broader issue, that I would recommend the Fund staff to consider addressing in future missions, is to advise how best Tonga can develop and structure safety nets or capacities for quick responses to shocks, be they natural, economic or commercial in nature.

On the national budget side, it is clear that much more effort is required by the authorities to arrest the deteriorating fiscal position of recent years. Judging from the experience of several other similar microstates, the domestic fiscal budget is one of the common sources of macroeconomic imbalance that often gets translated into pressure on the external and monetary sectors. Furthermore it is so quick for macroeconomic imbalances to escalate as the authorities respond to short-term pressures, but it tends to take a relatively long time to correct the situation. What is essentially required here is for the Tongan authorities to adopt a firm medium-term strategy that is consistent with strengthening the fiscal framework through a review of the tax exemption system, a broadening of the tax base and implementation of current expenditure ceilings, to name just a few possible ideas.

On the banking side, I would support the staff suggestion and the two other previous speakers with regard to the passing of legislation that will strengthen the soundness of the banking system. In that respect, the technical assistance provided by the Fund in the form of a bank supervision advisor should, in my opinion, be extended to the setting up and training of local counterparts in setting up a strong bank supervision unit within the National Reserve Bank of Tonga.

One of the major challenges in the years ahead for Tonga is to preserve the political stability that has traditionally held together and served the interests of this island kingdom. As we have seen in other societies, if the interests of donors and foreign private investors are to be maintained, it will be necessary for the authorities to implement prudent and sustainable policies.

The staff representative from the Asia and Pacific Department agreed that the poor financial condition of public enterprises adversely affected the budget and long-term growth prospects of the economy. The footnote on page 19 in the background paper was included because the staff was encouraged by the government's plans to improve the performance of the public enterprise sector. It showed the government's awareness of the need to tackle boldly the problems afflicting the public enterprise sector. The World Bank, together with the Pacific Financial Technical Assistance Center, was assisting the authorities in that regard.

Mr. Zamani added that, on behalf of his Tongan authorities, he wished to thank the staff for its work. He thanked Directors for their comments, which he would convey to his authorities, particularly Mr. Yakub's point that the unique geographical position of Tonga inhibited, to some extent, its development.

The Acting Chairman made the following summing up:

Executive Directors broadly agreed with the staff appraisal. They observed that economic conditions had deteriorated since the last consultation, as indicated by the fall in output, the worsening of the external position and various debt indicators, and the rise in inflation.

In that situation, Directors considered that the immediate task was to strengthen macroeconomic policies, and ultimately to accelerate growth. Directors called for the tightening of monetary and fiscal policies, notably by restraining wage costs, so as to attain the budgeted recurrent surplus for 1996/97.

Directors stressed the need for a well-defined medium-term fiscal framework, requiring the authorities to address serious weaknesses in the fiscal structure, including the poor financial condition of public enterprises, the costly noncontributory pension scheme, the narrow tax base, and the extreme compression of operations and maintenance expenditures. In resolving those problems, the authorities were encouraged to make fuller use of the extensive technical assistance at their disposal.

Directors endorsed the authorities' financial sector reform plans, including their intention to shift to indirect monetary management. However, they noted that weaknesses in the balance sheet of the National Reserve Bank of Tonga (NRBT) prevented it from fully deploying its indirect instruments. To alleviate that situation, Directors repeated their past recommendation that the NRBT's profitability be strengthened, including through a recapitalization, stressing that action was needed urgently. In addition, legislation needed to be passed speedily to enable the NRBT to set up an adequate prudential framework. They urged the authorities to take preventive measures to strengthen the soundness of the banking system.

Directors observed that, over the medium term, Tonga's principal economic problem was the grim outlook for the growth rate. They urged that highest priority be given to encouraging the private sector to expand and to scaling back the large public sector. In particular, they recommended that the tax system be reformed to become neutral, broadly based, and business friendly, and that the discriminatory and ineffective industrial incentive scheme be abolished.

Directors also underscored the need to strengthen the statistical base, in particular the national accounts and government finance data, in order to help economic policymaking.

It is expected that the next Article IV consultation with Tonga will be held on the standard 12-month cycle.

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/97/5 (1/22/97) and EBM/97/6 (1/27/97).

3. PAKISTAN—WAIVER OF APPLICABILITY OF PERFORMANCE CRITERIA

Notwithstanding the nonavailability of data with respect to the end-December performance criteria under the Stand-By Arrangement for Pakistan (as amended), Pakistan may proceed to make a purchase in an amount equivalent to SDR 53.58 million until January 31, 1997 (EBS/97/4, 1/16/97).

Decision No. 11430-(97/6), adopted
January 22, 1997

4. SUDAN—OVERDUE FINANCIAL OBLIGATIONS —REPORT AND COMPLAINT UNDER RULE S-1

1. The complaint of the Managing Director dated January 22, 1997, regarding Sudan's overdue financial obligations with respect to special drawing rights, in EBS/97/8 (1/22/97), is noted. It shall be placed on the agenda of the Executive Board on January 31, 1997.

2. Consideration of the complaint under Rule S-1 is a matter particularly affecting Sudan. The member therefore has the right to present its views through an appropriately authorized representative at the meeting at which the complaint is considered and at such subsequent meetings as the Executive Board may hold on the subject matter of the complaint.

Decision No. 11431-(97/6), adopted
January 24, 1997

5. APPROVAL OF MINUTES

The minutes of Executive Board meetings 96/8, 96/10, 96/12, and 96/32 are approved.

6. EXECUTIVE BOARD TRAVEL

Travel by Executive Directors as set forth in EBAM/97/6, Supplement 1 (1/21/97), EBAM/97/8 (1/17/97), EBAM/97/10 (1/22/97), and EBAM/97/12 (1/23/97), by Advisors to Executive Directors as set forth in EBAM/97/10 (1/22/97) and EBAM/97/12 (1/23/97), and by an Assistant to Executive Director as set forth in EBAM/97/9 (1/17/97) is approved.

APPROVAL: April 21, 1997

REINHARD H. MUNZBERG
Secretary