

April 11, 2006
Approval: 4/18/06

INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 06/24-5

3:50 p.m., March 10, 2006

**5. Poverty Reduction and Growth Facility and Exogenous Shocks Facility Trust—
Proposed Amendment to the Instrument to Authorize the Managing Director to
Enter into Borrowing Agreements on Behalf of the Trust and Accept Donations for
the Subsidy Accounts**

Documents: EBS/06/24 and Supplement 1

Staff: Plant, PDR; Tweedie, FIN; Steinki, LEG

Length: 47 minutes

Executive Board Attendance

T. Kato, Acting Chair

Executive Directors	Alternate Executive Directors
	M. Melhem (SA), Temporary
K. Bischofberger (GR)	O. Cuny (FF)
	M. Kaplan (UA), Temporary
	T. Miyoshi (JA), Temporary
	S. Rottier (BE), Temporary
	M. Roovers (NE), Temporary
	P. Charleton (CO)
	S. Rouai (MD), Temporary
B. Misra (IN)	A. Herat (IN)
	A. Tolstikov (RU), Temporary
	G. Campos (AE), Temporary
	M. Stone (AU), Temporary
D. Ondo Mañe (AF)	L. Rutayisire (AF)
	G. Cipollone (IT), Temporary
	H. Mori (BR), Temporary
T. Scholar (UK)	M. Martínez (CE), Temporary
	S. El-Khoury (MI)
	J. Sigurgeirsson (NO)
	J. Cuevas (AG), Temporary
	H. Ou (CC), Temporary
	M. Lanz (SZ), Temporary
	W. Wesaratchakit (ST), Temporary

A. Linde, Acting Secretary

S. Maxwell, Assistant

Also Present

Asia and Pacific Department: L. Molho. External Relations Department: B. Murray. Finance Department: E. Budras, S. Cauchi, J. Lin, R. Price, Y. Sun, A. Tweedie. Legal Department: H. Elizalde, B. Steinki. Middle East and Central Asian Department: A. Tahari. Policy Development and Review Department: M. Allen, M. Plant, B. Umansky. Secretary's Department: K. Meyers, M. Yslas. Western Hemisphere Department: W. Keller, M. Mansilla. Senior Advisors to Executive Directors: O. Hollensen (NO), A. Ismael (AF), D. Mohanty (IN), C. Roos Isaksson (NO), G. Shbikat (MI). Advisors to Executive Directors: H. Caracalla (MI), S. Ladd (CO), V. Srinivas (IN), L. Whyte (UK).

5. POVERTY REDUCTION AND GROWTH FACILITY AND EXOGENOUS SHOCKS FACILITY TRUST—PROPOSED AMENDMENT TO THE INSTRUMENT TO AUTHORIZE THE MANAGING DIRECTOR TO ENTER INTO BORROWING AGREEMENTS ON BEHALF OF THE TRUST AND ACCEPT DONATIONS FOR THE SUBSIDY ACCOUNTS

The staff representative from the Finance Department (Mr. Tweedie) made the following statement:

As Directors are aware, as part of putting the Exogenous Shocks Facility in operation, we need to raise resources, and the Managing Director briefed the Board on Wednesday on the status of our requests for subsidy contributions to the ESF. Those contributions all come in the form of an agreement, either direct grant or loan agreements, which are quite detailed. The purpose of the staff paper before you today is a fairly narrow one, which is to delegate from the Board to the Managing Director the authority to enter into specific loan and grant agreements with creditors and with donors for this purpose under the PRGF-ESF Trust Instrument.

The objective is essentially an issue of streamlining. Otherwise, it could be fairly cumbersome because, these agreements are quite technical and complex. They tend to follow fairly standard formats but, if we do not amend the Trust Instrument, they would all have to come to the Board and be approved on a lapse-of-time basis. Any change to those agreements, the need for which arises from time to time for purely operational reasons, would also have to come to the Board. Thus, we felt it is in the interest of the Board and of the staff to streamline the process.

A similar change was approved by the Board in the case of the PRGF-HIPC Trust Instrument in early 2000, as noted in Footnote 1 of the paper. We could have made the change at the time that we amended the Trust Instrument for the MDRI and to introduce the ESF, but given the complexity of the exercise, the decision was taken that we would not make any changes other than those required to implement the MDRI and introduce the ESF. The need for this change only became fully apparent once we started talking to contributors about receiving their contributions. Obviously we are very anxious to do that, and the contributors are anxious to provide those resources, which we are also very pleased about.

The staff considers this proposal as a minor change. All the agreements that would be entered into would still be governed by the terms of the PRGF-ESF Trust Instrument and, as we note in the paper, we will keep the Board fully informed of all these agreements in the context of our regular updates on the financing of PRGF-ESF operations.

The Acting Chair (Mr. Kato) remarked that Mr. Misra had proposed an amendment to the decision, which was contained in Supplement 1 to EBS/06/24.

Mr. Misra made the following statement:

Let me clarify at the outset that the amendment that I proposed is not meant to stall the MDRI process, but to correct what I feel are certain distortions. I had sent a memorandum to the Secretary, which is attached to the staff's note (EBS/06/24, Sup. 1). I assume all my colleagues have understood my objective in reflecting the distortions in the chart included in my note. After I explain my position, I am happy to answer questions Directors may have.

Coming back to the staff's comments on my proposal, I agree that the contributions are voluntary. Clearly, it is for the country, even in dire distress, to decide to make contributions. Having said that, is the IMF so short of funds that it has to take monies from poor countries, themselves under Fund-supported programs for a fair length of time, and often owing huge amounts of monies to the Fund as well as other IFIs? Should they be given the option to donate funds when their economic profile makes them request financing on a continuous basis? The staff's remark that the balance of payments position could be stable, therefore they are providing funds, is not relevant, but I will come back to that later.

If my argument is taken to its logical conclusion, it would mean that the same set of countries would be free to donate once they are out of the program, and the bar I am proposing would no longer apply to them. My point is that a poor country ought not to be donating either to the poor or more poor. The moment their economic situation improves and their economy allows, they can provide contributions. My proposal is that the IMF should bar them from giving it today, but after a few years, if their economic situation is good, they can contribute.

Secondly, I feel this is a poor governance practice, which we decry, that the countries donate just for internal populism, to announce back in their own capitals that they have given funds to the IMF. For example, it would be tantamount to Sri Lanka and Maldives contributing to ENDA, which is another trust fund, when they themselves are devastated by tsunami and seeking huge external assistance; or HIPC countries contributing to PRGF-ESF accounts after their balance of payments position improves, they would be in a position to contribute to the PRGF-ESF Trust. It would be very strange that after writing off enormous amounts of debt, as soon as the balance of payments position is better, they say they are contributing to an IMF-administered trust fund from which they borrowed money. I hope this addresses the staff's concerns.

The chart that I have attached to my note, with Bangladesh falling into a particular pattern, is a peculiar case. The Managing Director's letter dated November 23, 2005 gives each country until December 13, 2005 to approve the proposed structure of the amendments, but not where their money should be allocated. All countries are given the same option to give the approval to the

proposed structure of amendments and division of one trust to three trusts. Annex I to that letter gave them the time to offer the allocation of their own residual funds to any one of the three funds by January 23, 2006. Bangladesh's first letter dated December 12, 2005 approved only of the proposed amendments.

In a subsequent letter of January 5, 2006, Bangladesh opted to place their funds not in MDRI-II, but in the PRGF Subsidy Account, which is one of the three accounts. On the same day, management transferred Bangladesh's contribution to the MDRI-II account, for which they had not been given permission. On the January 9, Mr. Kuhn contacted me to say that the funds already stood transferred. In order to transfer, they never gave permission because, from the Managing Director's desk to Mr. Kuhn's desk, it must have taken four days, but in the meantime Fund management had transferred Bangladesh's funds.

In the Managing Director's letter of November 23, there was no mention that January 5, 2006 was the last date. When I was in Delhi I came to know through mail from Ms. Krueger that January 5 was the last date. Suddenly how did this January 5 deadline arise? It is because HIPC countries were supposed to pay back to the Fund on January 5, but the Managing Director's letter at no point of time mentioned that the 5th was the last date.

Incidentally, much before that on December 6, 2005, since I felt the sample letter itself was extremely faulty, I had a detailed discussion with Ms. Krueger. She said she would be calling Mr. Allen, Mr. Kuhn, and Mr. Hagan for a meeting with me, which was held on December 9. At the meeting, I pointed out to them how I thought their letter was faulty. I had drafted a separate letter for India and Bangladesh, showed it to Mr. Hagan, and got his clearance, and sent the revised draft to my authorities. When I queried Mr. Hagan that under the earlier rules 60 days have to be given for permitting countries to place their monies into any of the three accounts, he said that Annex I wrongly mentioned January 23 as the last date, and that the procedural position was that within 60 days from the time a country approves the amendment, it has to give its option of where to place its funds; i.e., Bangladesh had time up to February 12, 2006. However, because suddenly this January 5 deadline came up, some monies had been transferred to the wrong account without Bangladesh's permission. It was irregular, but I am not stressing that point now.

After Bangladesh's money got transferred to MDRI-II, I had a look at the composition of MDRI-II. I found from the chart that I have given that Bangladesh is actually funding countries which are much richer per capita than itself. It further struck me as odd that the IMF should be taking money from countries who are under a particular program; it applies to ENDA, the PRGF-HIPC Trust, and all trust funds. I have not raised the other issues because the proposed amendment relates only to the PRGF-ESF account.

Since this outcome, I felt that countries which are under programs, and have not yet repaid the funds, should be excluded. Once they are outside a program engagement, they would be treated like any other country and would be able to contribute. To that extent, equality is also maintained. My larger objective was to amend this, not to stall the proposal. The staff has also mentioned in the note that, after all, the contribution is not too much; it is only \$7.2 million. That way, for the PRGF Trust, even the petroleum-producing and exporting countries have given only \$15 million, a paltry sum. So, the idea was to exclude them until they are out of a program relationship.

The Acting Chair (Mr. Kato) invited Directors' views on the staff proposal and Mr. Misra's amendment.

Mr. Misra remarked that the issue under discussion was the staff's note on his proposal, rather than a staff proposal on his amendment. There was a proposed amendment by management after the MDRI had been approved, which caused the reaction by Mr. Misra to offer an alternative proposal.

The Deputy General Counsel (Mr. Elizalde) replied that a determination would need to be made as to whether there were two proposals on the table or one proposal and one amendment to the proposal. From the staff's reading of Mr. Misra's proposal, it appeared to be an amendment to the staff proposal that had been submitted to the Board and, therefore, it should be considered first.

Mr. Misra, in response to comments by the staff, expressed an objection to the last paragraph of the staff note. He recalled that in every staff paper on a policy item, the staff asked whether the Board agreed with their approach, because it was ultimately the Board that would take a decision. It was wrong on the part of the staff to have suggested that the Managing Director's amendment may be adopted. The staff should have written the report and the last two lines should have read, "Does the Board agree with Mr. Misra's proposal?" It was for the Board, not the staff, to decide whether the proposal ought to be adopted or discarded.

Mr. Scholar made the following statement:

Thanks to Mr. Misra for setting out the background to his paper and proposal. If I have understood correctly what he had said and what he is proposing, there are two separate issues here. There is an issue of future contributions to the PRGF-ESF, where he has a particular proposal on how the decision might be amended, and there is also a backward-looking issue on past contributions in respect of the MDRI and, in particular, the case of Bangladesh.

If I take the second issue first, it is clear that contributions to the MDRI-II account were voluntary. When the 43 contributors to the PRGF Trust were asked for their approval to the amendments that were proposed to it, there were two questions they were asked. First, did they consent to the Trust Instrument being amended; and, second, did they consent to their contribution being transferred to the MDRI-II account? Those were separate issues. It would be quite possible for a

country to consent to the amendment to the Trust but, not consent to the transfer of the contribution and, in that case, that contribution would then remain in the PRGF Trust. I gather that there were some countries that did take that route, that they decided to keep their contribution where it was. I think I have understood that correctly.

In the case of Bangladesh, this is of course, a bilateral matter between Bangladesh and the Fund, not a Board matter, and so none of us have been involved. From an ex ante standpoint, either Bangladesh gave their consent for the money to be transferred, in which case transferring it would be the proper thing to do, or they did not give their consent, or possibly because of some confusion it was thought that they had but they in fact had not, and in that case I would hope that it would be possible for the issue to be resolved bilaterally between Bangladesh and the Fund, because clearly funds should not be transferred if the country has not consented to that.

The second issue is a forward-looking issue about the framework for accepting contributions to the PRGF-ESF Trust in the future. Here, I would very much agree with Mr. Misra's comment that this must be a voluntary basis, as I think is the intention. The staff proposal is to line up the procedures for accepting donations with the procedures that have always been followed for the PRGF-HIPC Trust. It seems to me that it is both tidy from a housekeeping point of view to do that, but also the PRGF-HIPC Trust has been in operation for seven years with a well-established mode of operation which seems to have worked satisfactorily. So, when I first saw the proposal from the staff, it was something that seemed entirely sensible and that we would support.

Turning to Mr. Misra's proposed amendment to it, I can understand the perspective which draws him to this proposal. Indeed, when I first looked at the list of the 43 contributors to the PRGF Trust, I was surprised by some of the countries that I found there, including some very poor countries; I was surprised that those countries would have decided to make a contribution to the PRGF. But it seems to me that that is the choice of the country concerned and it is not for me, and I would not have thought really for the Board, to decide ex ante which countries could and which countries could not make a contribution. I imagine that if we tried to do that, that would get us into some quite difficult legal issues around the uniformity of treatment, because on what basis would we refuse a contribution from a country that wanted to make it? So, while I had the same surprise that I think Mr. Misra had in seeing which countries were there, it would seem to me that the staff proposal would be a sensible one. We would want to underline, and perhaps we would do that in the summing up of the meeting, that it was very clearly a voluntary decision by the country concerned whether or not to make a contribution.

I have got one final point, which is a question on the issue of timing. Until this decision is settled, as I understand it, no country can make a further contribution in respect of the various commitments that they have made. My authorities have made commitments to make contributions in respect of the MDRI and the Exogenous Shocks Facility, and they are very keen to make those payments. Like every country, we have a budget cycle, and there were certain contributions that were entered in to be paid in this budgetary year to the Fund. This budgetary year is rapidly drawing to a close for us, and so we are very hopeful that we can agree today on a way forward so that this can be drawn to a close, and that we and others who have got contributions pending can then make those payments.

Mr. Bischofberger thanked Mr. Misra for raising the issue and the staff for their additional comments. On the forward-looking issue, Mr. Scholar's distinction was correct and, on balance, the staff's reasoning was convincing. In particular, it was clear that the provision of loans or subsidies to any Trust established or administered by the Fund was purely voluntary and it would, therefore, not seem appropriate for the Fund to preclude such contributions by members only because they may benefit from the resources of the Trust in question. Therefore, the amendment of the PRGF-ESF Trust Instrument as originally proposed by the staff was acceptable.

Mr. Misra agreed with Mr. Scholar that the Bangladeshi issue was not part of the policy being discussed. It was a separate matter and would be sorted out bilaterally, but was used only as an example to illustrate the argument. As for the forward-looking issue, as mentioned in the note, contributions were clearly voluntary. The request was for an amendment to have the Trustee exclude countries that had not yet made contributions and were engaged in Fund-supported programs. As to Mr. Scholar's comments, there was no issue related to countries that wanted to contribute, and as the Board would decide shortly, there would be no delay in contributions being accepted. Conceptually it was difficult to accept a situation in which, for instance, the Maldives, totally destroyed, would request \$2 billion and then contribute \$100,000. The list of countries that wanted to contribute was surprising, as mentioned by Mr. Scholar, which was the reason why the policy should be amended to preclude program countries to give. Whatever the Board decided today, there would be no further delay; the idea was to correct the incongruity in the Fund's policy.

Mr. Rottier agreed with Mr. Scholar on the voluntary aspect of contributions. At the same time, there could be some risk of moral suasion as pointed out by Mr. Misra if PRGF-eligible countries were contacted by management to make contributions. In that context, for the ESF, the Managing Director had mainly stressed that he had contacted industrial and oil-exporting countries, but not countries under PRGF-supported programs. It was reasonable to assume that the same approach would be taken for future PRGF contributions, in which case there did not appear to be any risk of moral suasion.

Mr. Cuny expressed support for the initial staff proposal and considered it a sensible way forward. Regarding Mr. Misra's amendment, his comments were useful as they brought forward an important debate. Nevertheless, as mentioned by Mr. Scholar, it was not for the Board to decide, ex ante, who could or could not contribute. Like Mr. Scholar's authorities, the French

authorities had also committed some funds for the Exogenous Shock Facility—\$1 billion in terms of loans and \$30 million in terms of the grant element. It would be preferable to disburse that contribution as soon as possible, and conclude the debate at hand.

Mr. Sigurgeirsson associated himself with the views of Messrs. Bischofberger, Scholar, and Cuny that contributions should remain voluntary, and therefore could not support Mr. Misra's amendment.

Mr. Cipollone thanked Mr. Misra for raising the issue. However, when the Fund approved a program, it was the Board who approved it. Mr. Misra implied that if a country provided resources to the Trust Fund and the country entered a program or was already in a program relationship, there was moral hazard. It was for the Board to decide if the program was deserved or not, so there did not appear to be moral hazard. Moreover, the approach described by Mr. Misra could be problematic in future cases, for instance in the context of a Trust Fund for the financing of technical assistance. It was possible that a country would contribute to such a new trust fund, but if in the future it wanted to benefit from the trust fund, it would not be able to continue contributing. As Mr. Scholar said, since it was voluntary, the Managing Director would have to reject any proposal from a member to contribute if Mr. Misra's proposal were adopted. On what legal basis could management reject a voluntary contribution?

Mr. Misra said that he wanted to clarify his objective for calling the meeting. Mr. Cipollone had expressed doubts that, if a country had contributed funds to the account, why could it not enter a Fund-supported program tomorrow? The answer was it could. The key point was that if the country had already been in a program for years, that country would have no business donating to a trust fund when it ought to be tightening its own finances. The second issue was whether the Managing Director could refuse contributions. He could not refuse unless the Board decided to accept the proposed amendment.

Mr. Cipollone thanked Mr. Misra for the explanation, but still could not understand the moral hazard involved. When a country was already involved in a Fund-supported program, it had already benefited from the resources. The question was, how could a Trustee—the Board in this case—of a group of countries reject the voluntary contribution from a member?

Mr. Misra indicated that it was up to the Trustee to decide what types of funds it would accept. For example, the Trustee would not accept laundered funds. In the case at hand, the funds were not laundered, but there was some question as to the soundness of the decision. There were cases of program countries that, only for populism inside the country, would contribute for supporting other poor countries. But, very poor countries giving had no meaning. Countries that had money to give, whose finances were in first-rate order were free to contribute as much they pleased and there was no moral hazard in that.

Mr. Kaplan expressed support of the initial staff proposal.

Mr. Rouai suggested that it might be useful to recall why there were a number of low-income countries contributing to the PRGF Trust. The history went back to the late 1980s, when the Fund wanted to create the ESAF and move away from the SAF. At that time, there was a strong feeling in the Board to involve all countries in providing financing support to low-income

countries, even through a minimum contribution. There were some countries who contributed less than SDR 5,000, just to show that they were involved in an international effort. Of course, when there was a problem of debt reduction and a country contributes at the same time, there was a different position. This was the background and perhaps it would offer some explanation to those who wondered why there were so many low-income countries wanting to contribute.

Mr. Charleton, indicating that he had listened carefully to Mr. Misra's comments and understood the basis of his position, said he had great difficulty with the principle that would actively preclude members from voluntarily contributing to a trust fund. As Mr. Rouai had indicated, the poor countries often wanted to contribute on a voluntary basis, and it was understandable that some countries would make very small contributions to be part of the overall effort. But it would be strange and perverse if the Board were to refuse to accept a contribution from a member, and it would be unfair to the countries who were offering it. Many countries, even though they were poor, might well want to make a very small contribution. Therefore, the original staff proposal should be adopted.

Mr. Misra said he was grateful to colleagues for participating in the discussion, but was not surprised that Directors' views were not in favor of his amendment. He wanted to clarify the issue for the future, but would be in favor of whatever decision the Board would ultimately adopt. It was not necessary for a country to be a contributor to feel like a part of the international community; borrowers were also included.

The Acting Chair (Mr. Kato) stated that there was not sufficient support to adopt Mr. Misra's amendment, whereas the proposed decision of the staff had broad support.

The Executive Board took the following decision:

Poverty Reduction and Growth Facility and Exogenous Shocks Facility Trust—Amendment

The Instrument to Establish the Poverty Reduction and Growth Facility and Exogenous Shocks Facility Trust, annexed to Decision No. 8759-(87/176), shall be amended as follows:

- (a) The following new sentence shall be added at the end of Section III, Paragraph 2:

“For this purpose the Managing Director of the Trustee is authorized to enter into borrowing agreements and agree to their terms and conditions with lenders to the Loan Account of the Trust.”

- (b) The following new sentence shall be added at the end of Section IV, Paragraph 2:

“For this purpose the Managing Director of the Trustee is authorized to accept donations of resources and agree to their terms and conditions with donors to the Subsidy Accounts of the Trust.”

- (c) The following new sentence shall be added at the end of Section IV,
Paragraph 3:

“For this purpose the Managing Director of the Trustee is authorized to enter into borrowing agreements and agree to their terms and conditions with lenders to the Subsidy Accounts of the Trust.” (EBS/06/24, 2/22/06)

Decision No. 13689-(06/24), adopted
March 10, 2006

APPROVAL: April 18, 2006

SHAIENDRA J. ANJARIA
Secretary