MASTER FILES
ROOM C-525

NOT FOR PUBLIC USE

0404

INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 90/21

3:00 p.m., February 20, 1990

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

Executive Directors	Alternate Executive Directors
G. K. Arora	L. E. N. Fernando
	C. Enoch
C. S. Clark	
Dai Q.	
T. C. Dawson	B. S. Newman, Temporary
J. de Groote	
E. T. El Kogali	
E. A. Evans	S.-W. Kwon
E. V. Feldman	R. J. Lombardo
L. Filardo	M. A. Fernández Ordóñez
R. Filosa	
M. Finaish	A. M. Othman
	I. H. Thorláksson
	O. Kabbaj
G. Grosche	
J. E. Ismael	T. Sirivedhin
A. Kafka	L. M. Piantini
J.-P. Landau	
Mawakani Samba	
	M. Al-Jasser
G. A. Posthumus	G. P. J. Hogeweg
K. Yamazaki	S. Yoshikuni

L. Van Houtven, Secretary and Counsellor
M. J. Miller, Assistant

Also Present
IBRD: D. C. Rao, Director, Risk Management and Financial Policy Department. African Department: M. Touré, Counsellor and Director; C. Enweze, R. C. Williams. Asian Department: M. W. Bell. Exchange and Trade Relations Department: L. A. Whittome, Counsellor and Director; T. Leddy, Deputy Director; G. R. Kincaid, J. P. Pujol, M. Shadman-Valavi, B. C. Stuart. External Relations Department: E. Ray. Legal Department: F. P. Gianviti, General Counsel; W. E. Holder, Deputy General Counsel; R. H. Münzberg, Deputy General Counsel; A. O. Liuksila. Middle Eastern Department: S. H. Hitti. Research Department: P. Isard, S. Takagi. Secretary's Department: A. Tahari. Treasurer's Department: D. Williams, Deputy Treasurer; J. E. Blalock, D. Gupta, B. E. Keuppens, O. Roncesvalles, G. Wittich. Western Hemisphere Department: S. T. Beza, Counsellor and Director; J. Ferrán, Deputy Director. Office of the Managing Director: A. K. Sengupta, Special Advisor to the Managing Director; E. A. Milne. Special Advisor to the Deputy Managing Director: W. A. Beveridge. Personal Assistant to the Managing Director: H. G. O. Simpson. Advisors to Executive Directors: M. A. Ahmed, M. B. Chatah, K.-H. Kleine, Z. Iqbal, J. M. Jones, P. O. Montórfano, B. S. Newman, D. Powell, F. A. Quirós, A. Raza, S. P. Shrestha. Assistants to Executive Directors: N. Adachi, T. S. Allouba, G. Bindley-Taylor, B. A. Christiansen, S. K. Fayyad, A. Fernandez, B. R. Fuleihan, M. A. Ghavam, S. Gurumurthi, M. Hepp, J. Heywood, L. Hubloue, C. Y. Legg, G. Montiel, J. A. K. Munthali, D. Saha, J.-P. Schoder, G. Serre, J. C. Westerweel.

1. JAPAN - TECHNICAL ASSISTANCE PROJECTS - ESTABLISHMENT OF ADMINISTERED ACCOUNT

The Chairman stated that he had great satisfaction in reporting that Japan had made a generous offer to extend grants to the Fund to help fund technical assistance programs. The Japanese authorities recognized that a large number of developing countries faced a very difficult task of reducing macroeconomic imbalances, reshaping their economic structure, and fostering long-term development. They were convinced, based on their own experience of postwar development, that the strengthening of institutions and human resources for administration of sound economic policies was the key to successful structural adjustment in those countries. The Fund's technical assistance programs played a central role in that area. The Japanese authorities had thus proposed establishing at the Fund an administered account that would receive grants from Japan and meet or reimburse the Fund's General Resources Account for expenditures related to selected technical assistance programs. The Japanese grants could be used for developing countries which had debt-related difficulties or which were trying to avoid such difficulties. They could be used for technical assistance programs in the areas in which the Fund had traditionally extended its assistance--organization of seminars, tax policy administration, budgeting, central banking, and statistics.

The Japanese grant would enable the Fund to finance a part of its existing technical assistance and to enlarge its scope, the Chairman concluded, which would be very helpful in the context of the Fund's tight budgetary constraints. Japan had already extended similar assistance to the World Bank, including funding of costs associated with preparation of project or program loans, and human resource development projects. He welcomed the offer and the support it showed for the Fund and for the Fund's developing members. A staff paper with a proposed instrument establishing the Technical Assistance Account would be circulated shortly, and the issue would be placed on the Board agenda around mid-March. He requested that Mr. Yamazaki convey to his authorities management's gratitude.

Mr. Yamazaki stated that his authorities had strongly supported the Fund in its central role in the international monetary and payments system. In that vein, Japan would like to contribute resources to an account administered by the Fund in order to strengthen Fund technical assistance. In the view of his authorities, such a contribution would help Fund members enhance their administrative capacity and their capacity to formulate, implement, and maintain macroeconomic and structural adjustment programs.

As the Chairman had said, the staff paper would be circulated shortly and the Board would have an opportunity to discuss the Japanese request based on it, Mr. Yamazaki continued. He would like only to convey the sincere hope of his authorities that the Board would support the initiative.

He wished to thank the Chairman for the encouragement he had given the Japanese authorities in pursuing that initiative, and to express their appreciation to the Special Advisor to the Deputy Managing Director and the staff of the Exchange and Trade Relations, Legal, and Treasurer's Departments for their cooperation in developing it, Mr. Yamazaki concluded.

2. OVERDUE FINANCIAL OBLIGATIONS - STRENGTHENED COOPERATIVE STRATEGY

The Executive Directors continued from the previous meeting (EBM/90/20, 2/20/90) their consideration of a statement by the Managing Director on proposals to strengthen the cooperative strategy on overdue financial obligations to the Fund, taking up the section of the statement dealing with measures of deterrence.

Mrs. Sirivedhin stated that she had no problem with the sequence proposed for the application of deterrent measures. With regard to the timing, however, she would prefer some flexibility in the system, in order to take account of cases in which attempts to cooperate were being made, but in which the efforts might be hampered by political or external factors. Some cases might indeed require more time; it was as yet unclear what would be involved in the procedure for compulsory withdrawal. What might be expected to happen between the time the Board initiated the procedure and the actual withdrawal, she wondered; perhaps the staff could elaborate. Members needed to be given enough time to consider all the aspects of an amendment of the Articles, which would be needed in order to introduce the intermediate step of suspension of voting and related rights. She therefore agreed with the Managing Director's suggestion to give priority to the measures that were immediately available. The Board could not be hasty in considering an amendment.

The General Counsel stated that the effectiveness of any resolution on compulsory withdrawal could be determined in the resolution of the Board of Governors itself. For example, the resolution could specify that the member would be forced to withdraw only after a certain grace period within which the member would have an opportunity to resume cooperation with the Fund. The effectiveness of the withdrawal itself would be subject to a number of procedural steps. The settling of accounts between the member and the Fund would need to take place, offsetting the member's indebtedness to the Fund against the Fund's holdings of the member's currency. The member, by either voluntary or compulsory withdrawal, would lose its entitlements to any capital gain on its gold payment to the Fund, and that gain would thus not be taken into account in the settlement of accounts.

There was a difference between a member's entitlement to the capital gain on the gold payment under conditions of its withdrawal and the liquidation of the Fund, the General Counsel pointed out. In the case of liquidation, members which had joined the Fund before September 1, 1975 would be entitled, on the basis of their quotas on that date, to the capital gain on their gold payments, namely, the difference between the gold price of SDR 35 per ounce which had existed until then and the current market price. If the Fund were to be liquidated, members in arrears would be credited with the capital gain on the gold payment portion of their subscriptions, which would then be added to their assets in the Fund before offsetting overdue financial obligations were taken into account. In contradistinction, the gain on the gold payment was not taken into account when members withdrew from the Fund.

In response to a question from Mr. Enoch, the General Counsel said that withdrawal from the Fund would entail automatic withdrawal from the World Bank as well, unless the Bank's Executive Board, by a 75 percent majority of the total voting power, voted to authorize the country to remain a member of the Bank.

Responding to a question from Mr. Newman, the General Counsel stated that if the withdrawing member did not repurchase its currency, the Fund would have the right to sell it. Any losses incurred by the Fund in connection with the withdrawal of a member would reduce the Fund's net income for the current year. Any resulting deficit would be charged to the Fund's special reserve and the balance, if any, to the general reserve. Moreover, the Fund had established the Special Contingent Account, to which losses related to overdue repurchases would be charged even before the year's net income was reduced. If all of the Fund's income and precautionary balances together were not sufficient to cover the loss, the Fund's capital--its quotas--would be impaired.

The Chairman commented that the Board would not necessarily have to decide to make a finding of loss as long as it believed that there was a chance to recover the Fund's claim from the member.

Mr. Grosche observed that because a member in arrears was already causing a type of impairment of the Fund's capital by not making its repurchases, and was thus influencing the Fund's liquidity and reserves position, the only real difference between a member's not making repurchases and the Fund's taking a loss stemming from a withdrawal was that in the latter case the Fund was officially making a correction in its reserves, and in that sense, was recognizing a loss that had already occurred.

The General Counsel said that there was a difference between the liquidity of the Fund and the valuation of its assets. The liquidity of the Fund could be said to be impaired when the Fund held the nonusable currency of a member which was not fulfilling its repurchase obligations, but the value of the Fund's assets could not be said to be impaired if the member was in compliance with its maintenance of value obligation. The time might come when the Board could conclude that the value of the assets had been impaired, however, because of a probable loss in a settlement of accounts with a withdrawing member.

Mr. Newman remarked that if the Fund's reserves were insufficient to cover a loss, the total amount of the Fund's quotas would decrease in order to compensate for the amount not covered, unless offsetting actions were taken, such as through the mobilization of the Fund's gold. If the Fund were, in the case of compulsory withdrawal, to reserve to itself the capital gain on the gold payment portion of the subscriptions of members withdrawing, then it could decide to mobilize that gold portion in advance, before compulsory withdrawal, in order to restore the member's position in the Fund. Such a course of action would, in effect, merely be garnishing the profits from gold at an earlier stage--before, rather than after, compulsory withdrawal.

The Deputy Treasurer explained that the gold would not be utilized at all under compulsory withdrawal. If the Fund's current income were insufficient to cover the loss, and the general and special reserves and the Special Contingent Account were all exhausted and still the loss was not covered, then the loss would go against the usable currencies, thus enlarging the reserve tranche positions of the members issuing those usable currencies.

Mr. Newman said that the last time the Fund had had insufficient income without adequate reserves, it had in effect sought to increase reserves by establishing a gold sales arrangement with certain members, for the purpose of generating income-producing resources that would contribute to a reserve to enable the Fund to meet its administrative expenditures. In that way, the Fund had not had to draw down its usable currencies. There was thus a precedent for using gold, and a provision in the Articles to mobilize gold to deal with losses. The question, therefore, was not whether the Fund could do it, but at what stage.

The Deputy Treasurer confirmed that for the Fund's first seven or eight years it had had insufficient income to meet its administrative expenses, and, by using U.S. dollars to cover those expenses, had enlarged the reserve tranche position of the United States. In 1954 and 1958, the Fund had sold gold, on repurchase terms, in order to secure income to invest in U.S. treasury obligations, which thus gave the Fund interest income. Beginning in 1956, large transactions, especially with France and the United Kingdom, had caused the Fund's income to rise substantially. In conjunction with an increase in the rate of interest on U.S. treasury obligations, those transactions led to income beyond that needed for administrative expenses, and the Fund had then decided to create the Special Reserve. The bulk of the Special Reserve was in fact attributable to the investment of the proceeds of the gold sales. The Fund had repurchased the gold sales in the course of the 1960s and 1970s.

The General Counsel stated that the topic of investments by the Fund to generate income was discussed at the time of the Second Amendment of the Articles. A decision was ultimately taken to limit the Fund's ability to invest to the amount of reserves.

Mr. Newman pointed out that the Fund would still be allowed to invest SDR 1.5 billion under that stipulation.

Mr. Grosche observed that the possibility of sales and repurchases of gold by the Fund had been ruled out after the Second Amendment, at the insistence of the United States.

The Chairman said that although the use of gold in making repurchases was ruled out, gold sales were not.

Mr. Dawson observed that a sale of gold would be the easiest thing for the Fund to do under the present circumstances. Use of gold in a more limited way was in fact more difficult to accomplish under the current Articles of Agreement; indeed, some thought might be given to changing the Articles to allow gold to be used by the Fund in a more flexible way.

Mr. El Kogali remarked that he wondered whether countries, upon taking up membership in the Fund, were informed that if they fell into arrears they would be compelled to withdraw. He wondered further whether there was a provision in the Articles on rescheduling.

The Chairman said that any member which did not respect its basic obligations to the Fund could be exposed to compulsory withdrawal. The existence of a provision in the Articles allowing rescheduling would not prevent the Board of Governors, if it saw fit, from adopting a resolution on compulsory withdrawal because of arrears if it found that there were no prospects for cooperation with the Fund.

The General Counsel confirmed that the provision in the Articles on the postponement of a repurchase obligation conferred the possibility of rescheduling, but not an obligation, on the Fund. The Fund therefore did not have an obligation to reschedule before instituting measures on compulsory withdrawal. Compulsory withdrawal was possible as soon as an obligation was breached. The provision on rescheduling was intended to be limited in any case; any rescheduling beyond the maximum repurchase period would be subject to a finding of special hardship and a 70 percent majority of the total voting power in the Executive Board.

Mr. de Groote commented that the risk of compulsory withdrawal was indeed very real, since it had in fact been used in the case of Czechoslovakia.

In practice, Mr. de Groote noted, the legality of gold repurchases by the Fund might in the future depend on who the counterpart was--for example, whether it was the Bank for International Settlements or a market agent.

Mr. Evans said that he could support the deterrent measures the Managing Director had proposed. He could also support the proposal that Mr. Dawson had put forward for the suspension of voting and related rights of membership. He could understand the approach the Managing Director had taken, of proceeding with measures that could be implemented quickly while considering other matters further. He presumed that part of the reason for wanting to pursue the amendment was the concern that compulsory withdrawal would not prove possible in practice. He believed that that supposition needed to be tested. He wondered whether the problem of the requirement of an 85 percent majority of the total voting power in order to implement compulsory withdrawal should not be addressed through an amendment to the Articles. He had noted the General Counsel's reference to the World Bank procedures in which withdrawal from the Bank following withdrawal from the Fund was compulsory unless 70 percent of the voting power decided otherwise; it seemed that the Fund might need a change in its voting power majority in that respect.

The Board should proceed to consider withdrawal, Mr. Evans concluded. Withdrawal would clearly be considered only for cases in which the Board had judged that the countries concerned would not be cooperating with the Fund in the foreseeable future. In those circumstances, it was difficult to see why any Governor would vote against such a proposal. Nevertheless, it appeared that that would be the case. However, if the Board were to go down that route, and if it were to find that the requirement of an 85 percent majority of Governors was not met, then its determination to pursue an amendment of the Articles to address the issue directly might be helped.

Mr. Feldman stated that he could go along with the sequence of the deterrent measures as proposed in the Managing Director's statement. However, as several previous speakers had noted, he would not like to see the establishment of a fixed period of time for the adoption of those measures. The Board should not apply strict automaticity by fixing rigid time intervals between the adoption of one measure and the next; rather, the Board should allow itself the necessary time and flexibility to deal with each specific case on its own merits.

He was reluctant to support any provision on the suspension of voting and related rights of membership, Mr. Feldman concluded. He saw merit in strengthening the efficacy of the available arsenal of deterrent measures in the way the Managing Director had proposed in his statement. The Board had recognized that the arrears problem was circumscribed and not systemic, that gold utilization or a new allocation of SDRs were therefore not needed, and that a gold repurchase agreement would have required an amendment of the Articles, thus bolstering the argument that such a course should not be pursued. He believed that the same argument held in the case of an amendment on the suspension of voting and related rights of membership as well; pursuit of such an amendment should therefore be abandoned.

Mr. Kafka said that although he recalled that in previous discussions it had been thought that strengthening deterrents might be appropriate, he was not certain that the Board had firmly concluded that that was the case.

A timetable--as distinct from a firm sequence--of deterrent measures would not be helpful, in his view, as the timing should be left to the discretion of the Executive Board.

Initiating procedures for compulsory withdrawal three months after a declaration of noncooperation if the member remained in arrears and did not cooperate actively raised one very basic point, Mr. Kafka went on. It would be necessary to define, perhaps not exhaustively, but at least by example, what was meant by active cooperation. The delicate question of the content of the Fund-monitored program, and the even more delicate question of the financial support that the Fund was or was not able to raise for the country which was prepared actively to cooperate with it provided it could get adequate access to finance, thus came up. Those were matters which deserved, indeed required, very careful consideration before any conclusions were drawn.

Some of the recommendations regarding solicitation of support from the international community to strengthen the Fund's preferred creditor position might be counterproductive, Mr. Kafka pointed out. A declaration of ineligibility or a declaration of noncooperation should be enough to persuade the financial community to do what it should do. To be more insistent might prove embarrassing not only to those the Fund was addressing, but to the Fund itself.

He could agree to excluding a member from the right to subscribe to the increase in its quota only in two circumstances, Mr. Kafka remarked; first, if it was not cooperating actively according to an acceptable definition; such a definition need not be given in general terms, but could be given illustratively, describing both the nature of the program and its financial support. Second, the Fund as an institution should express its preparedness to give sympathetic consideration to a country cooperating with the Fund which had not been able to clear its arrears when the general period of consent expired. The case of the Islamic Republic of Iran in the Eighth General Review was a precedent.

He could not agree immediately to adopt any new measures outlined under deterrents, because too much remained to be adequately defined, Mr. Kafka concluded. He agreed with the Chairman that an amendment on suspension of voting rights should not be pursued at present; in fact, he believed that it would not be useful at any time.

Mr. Grosche stated that more precision was needed in the sequencing of steps leading to the declaration of ineligibility and afterwards. No more automaticity than had been implied by the Deputy Treasurer in the morning session (EBM/90/20, 2/20/90) should be permitted.

Given the time that would be needed to put into effect an amendment of the Articles of Agreement to allow a suspension of voting and related rights of membership, the Board should not delay in pursuing it, Mr. Grosche pointed out. He was confident that the other elements of the strengthened arrears strategy would yield results, but the Board should not wait for the outcome of those initiatives before pursuing an amendment of the Articles on suspension. In that connection, like Mr. Nimatallah, he believed that the Executive Board, by a special majority of 70 percent of the total voting power, should exercise the right to suspend members in individual cases.

Mr. Thorláksson said that the measures of deterrence were broadly acceptable to his chair. He agreed with the Chairman that the Board should exercise the existing instruments of deterrence before embarking on the work related to an amendment of the Articles in order to introduce the possibility of suspension of voting and related rights of membership. Nevertheless, he was concerned that the Managing Director's statement seemed to imply a direct link between a declaration of noncooperation and compulsory withdrawal. He was strongly against such an automatic link.

Mr. El Kogali said that he shared the view that a credible strategy on overdue obligations must have an element of deterrence. However, he had some reservations about the timing proposed for considering a declaration of noncooperation and for initiating procedures for compulsory withdrawal. Moving from the dispatch of communications to Fund Governors and selected heads of multilateral financial institutions to a declaration of noncooperation in only four months, followed by the process of compulsory withdrawal three months afterward, did not provide enough time to persuade members to cooperate fully with the Fund. Perhaps it would be more appropriate if six months were allowed to elapse after the dispatch of the letters before considering a declaration of noncooperation and a further six months to one year to elapse before beginning procedures for compulsory withdrawal. If persuasion was part of the driving force of the Fund's strategy, then seven months--perhaps even 12 months--would not be enough. The Fund needed to allow enough time for friendly governments to use their bilateral contacts to help persuade the member to accept the strengthened collaborative approach. Compulsory withdrawal should require a special majority of the Board of Governors. He would like to see a staff paper defining noncooperation in operational terms, so that a consensus could be reached on the ground rules.

The Chairman commented that long delays between actions by the Fund in cases of arrears had not helped matters, but appeared to have been interpreted as complacency or resignation on the part of the Fund. In that respect, not only repayments to the Fund, but the implementation of needed adjustment measures, had been delayed. Therefore, a somewhat tighter calendar for the implementation of the agreed steps might be more useful in the future both to the member and the institution.

Mr. El Kogali said that compulsory withdrawal was the severest form of punishment on a member. It was out of keeping for the Fund to begin discussing such severe steps after it had shown such patience in dealing with cases of arrears over the previous four years. The Fund should continue to persuade both the countries in arrears and their donors to solve the problem, for which more time was needed.

The Chairman observed that the Board had been considering compulsory withdrawal as a way of dealing with members in arrears since 1986.

Mr. El Kogali said that, as Mr. Arora had once pointed out, dealing with members in arrears should be different from the process of crime and punishment. Many countries in arrears were in that situation out of genuine hardship, both manmade and external, and they simply were unable to repay. He did not wish to defend arrears per se, but it needed to be borne in mind that a number of countries currently in arrears had followed Fund-supported programs for several years before they had entered into arrears, and that, for one reason or another, those programs had not been successful.

Mr. Nimatallah observed that if the Fund were to lengthen the period between a declaration of noncooperation and compulsory withdrawal, the pressure on the member would be less, so that it would be less likely to move quickly to resolve the arrears problem, which was the whole point of the threat of compulsory withdrawal. Making the period a short one would, paradoxically, help the country to avoid being expelled, in his view, because it would have greater pressures on it and more incentive to solve the arrears. A shorter period would also act as a more effective deterrent for members currently not in arrears from falling into arrears.

Mr. Dawson said that if the Fund were to introduce a new set of rules with respect to handling arrears cases, some transition period might be necessary, but it should not be too long. The Fund needed to serve notice that it would begin to deal more stringently and expeditiously with arrears cases. The Board had discussed most of the issues over the previous three to four years; the issue of suspension of voting and related rights of membership had been canvassed in a staff paper about three years ago. Members were therefore well aware of the currency of the topics. As Mr. Grosche had said, the present was the time to begin implementing an amendment of the Articles introducing the provision of suspension of voting and related rights of membership.

Mr. El Kogali said that a period of seven months between the declaration of noncooperation and compulsory withdrawal was not long enough to allow a country to mobilize funds to repay the Fund, or to come up with ideas for national rehabilitation. He could not understand why the Fund was in such a hurry. Seven months in the life of an institution like the Fund was insignificant. If a man was sick and needed treatment, he should be shown patience and care and the time he needed to recover. The same should apply to the hardship cases of arrears.

The Chairman commented that the more catastrophic the situation, the greater the need for immediate action.

Mr. El Kogali observed that once a country was forced to withdraw from the Fund, it would be unable to get help from any other quarter. What the Fund would be doing in that case was tantamount to execution.

The Chairman said that the country should realize it was in deadly danger far before the resolution on compulsory withdrawal. The declaration of noncooperation should be seen as the last warning in that respect.

Mr. Nimatallah remarked that the case of Poland could be taken as a good example of the speed that could be achieved in adopting a tough and demanding program. Poland had put together a program, negotiated it with the Fund, and implemented it all in the space of a few months. He wondered why other countries could not do the same.

Mr. Dawson said that the period of seven months was not quite precise, in that the total time might be more; in fact, it could be from one to two years.

The Chairman said that, in accordance with the timetable that had been presented by the Deputy Treasurer, it could be seen that the length of time could go up to one year, unless the Board decided in a particular case to proceed more quickly. The Board would also have the flexibility of making the time period longer. The key point was that members needed to be convinced that urgency should be attached to solving their arrears. Promising countries--in effect--that several years would pass before the Fund would come around to seriously addressing the problem would be counterproductive, and lull the member into a false sense of security. That would be damaging both to the country, which would continue with inappropriate policies, and to the Fund, whose liquidity position would be impaired.

Mr. El Kogali said that one of his principal concerns was that, if the proposed course of action were to be followed, one of the countries in his constituency would be expelled from the Fund by the end of the year.

The Chairman replied that the case of Poland might be noted in that regard. If the situation were bad enough and the will to adjust sincere enough, expeditious and effective action was always possible.

Mr. El Kogali, continuing with his statement, said that there was merit in the argument that strengthening the Fund's preferred creditor status would help to prevent arrears. He had never questioned the preferred creditor status of the Fund. However, the question of basic survival had often interfered with the intention to honor the Fund's preferred creditor status.

He could agree to the suggestion that creditors receiving payments from members in arrears to the Fund take the initiative to direct payments to the Fund, provided that that did not inhibit the flow of aid. The Fund should be careful not to be seen as actively encouraging aid agencies and other financial institutions to suspend or curtail assistance to a member in arrears to the Fund. To do so would not help the Fund's image, and it certainly could not be helpful to the member.

He would propose that the deadline for the period of consent for the increase in quotas under the Ninth General Review for countries in arrears to the Fund be the beginning of the Tenth General Review, Mr. El Kogali concluded.

Mr. Posthumus said that he had no major problems with the Managing Director's statement. However, with respect to the sequencing and timing of the deterrent measures, he believed that the possibility should be left open in certain cases for the Board to omit steps, or not to follow the sequence. There had been cases in which a member had taken a conscious decision to stop or reduce its payments to the Fund, which meant that cooperation with the Fund had then ended. Under the present circumstances, it took the Fund about six months before it determined whether a member was cooperating with it or not; the Fund should be able to react more quickly.

Although he was not optimistic about prospects for influencing other donors and creditors, Mr. Posthumus concluded, he could support what the Managing Director had included in his statement about bolstering the Fund's preferred creditor status. He supported the way the Managing Director had treated the issue of an amendment of the Articles and suspension of voting and related rights of membership. However, he had great difficulties with the link between the resolution on suspension and the quota increase itself. Perhaps that link could be discussed in more depth when the final package was circulated to Directors in the following days.

Mr. Landau stated that like Mr. Grosche, he believed that, if the Board indeed decided to go that route, it should begin considering a decision on an amendment of the Articles to introduce the possibility of suspension of voting and related rights of membership as soon as possible. The linkage of such an amendment to the resolution on the increase in quotas under the Ninth General Review needed to be examined, however. Because both resolutions would require legislative approval, perhaps they could be submitted to Governors simultaneously. Although it might be politically necessary to have a link between the two matters, it should not be necessary, from the legal perspective, to make the implementation of one resolution contingent upon the implementation of the other.

Mr. Nimatallah observed that the surest way to secure a special majority of Governors exercising 85 percent of the total voting power in favor of the resolution on the amendment of the Articles was to link it to the resolution on the quota increase. The Board would have to decide whether it wanted to go down that road at the present juncture; it could afford no more delays.

Mr. Dai said that he had noted from the Managing Director's statement that some deterrent measures had been strengthened without an amendment of the Articles. Although he had strong reservations about the modification and further strengthening of the newly established rules at present, he would be prepared to consider them provided that an amendment of the Articles could be avoided and agreement could be reached. If, as some had advocated, more severe punishment was warranted, then the existing provision on compulsory withdrawal was tough enough. In practice, if the decision on withdrawal was truly justified, the necessary majority would certainly support it.

The principle of implementing the strengthened deterrent and preventive measures on a case-by-case basis must continue to be adhered to, Mr. Dai stressed. A rigid timetable of different punitive steps would not be appropriate, since no case was identical to another. Moreover, special consideration should be given to exceptional cases, when the origin of arrears was beyond the member's control. For example, an unexpected world recession or turmoil in the international financial markets could make timely repayment difficult. Sometimes political conflicts between countries could cause a country to fall into arrears owing to economic sanctions--including frozen foreign assets--imposed by another country. In those circumstances, relying on punitive measures to prevent arrears would not work, regardless of how tough they might be.

Mr. de Groote stated that he could go along with the broad outlines of the Managing Director's statement on measures of deterrence. To be real, a deterrent should have to be used only sparingly, or even not at all. The Managing Director's approach took that fact into account, which was why he liked it.

In the debate between Mr. El Kogali and Directors in whose constituencies were potential support group members for Sudan, there had been some misunderstandings, Mr. de Groote continued. There were really two issues: first, the moment at which the Executive Board or the Governors considered certain measures; and second, the point at which those measures were activated. The timetable or schedule for the consideration of the measures needed to be precise, otherwise the deterrent would not be real. It would be up to the Board or the Governors after that to implement, or not, those measures, based on the circumstances of the case. For example, a case in which the first glimmers of cooperation with the Fund could be perceived would be handled differently from one in which the member continued a prolonged refusal to cooperate. It was important to keep separate those two issues.

Regardless of the political considerations, which he did not think should really enter into the discussion at that point in any case, it was his view that the question of the suspension of voting and related rights of membership should be examined on its own merits, Mr. de Groote observed. It made a lot of sense to interject another step between a declaration of noncooperation and compulsory withdrawal. Paradoxically, such a step might meet Mr. El Kogali's concerns, because the suspension of voting and related rights would introduce a solemn step with effective sanctions on the member, before the matter of exclusion from the Fund was pursued. The amendment on suspension should therefore not be taken up as a package, but looked at on its own merits. He found Mr. Landau's differentiation of the legal versus the political links quite interesting in that connection, but perhaps it was premature to discuss that facet at present.

With respect to the interesting exchange of views between the General Counsel and Mr. Grosche, he might observe that the Fund obviously could not lose the ownership of its gold by selling it, and then recover the ownership, Mr. de Groote concluded. However, as experience with the operations and investments of central banks had proven, it was possible to engage in transactions that would produce profits without entailing a transfer of ownership. Such transactions might be considered in the future. For example, investments had been made for some central banks through the Bank for International Settlements which had not entailed a transfer of property, because those banks had difficulty in acquiring ownership of certain assets over a long period of time. Consequently, they transferred the use of those assets that were temporarily at their disposal. They also had some assets on guarantee, and borrowed on that basis, from which they invested in income-producing assets. The National Bank of Belgium, when it purchased securities of finance companies on the U.S. market, did not necessarily acquire the ownership of those securities, because legally, ownership was maintained in the Bank for International Settlements, which provided the National Bank of Belgium with another income-producing asset in exchange.

Mr. Dawson commented that the concept Mr. de Groote seemed to be thinking of was a lease. He welcomed such creative thinking as applied to the arrears problem. It needed to be borne in mind that the considerations which had confronted the framers of the Second Amendment had been different from the ones confronting the Board at present, and the role of gold had been quite different at that time as well. Moreover, while the decisions on the use of gold adopted at the time of the Second Amendment needed to be taken into account, there was no reason why they should obstruct a more creative approach to resolving what had become a very serious problem for the Fund--arrears.

The Chairman observed that work on the SDR had also been undertaken at the time of the Second Amendment, and the Board had not been very creative in applying that instrument since then either.

He would welcome an initiative from the Interim Committee to look into the systemic questions raised by Mr. Dawson's observations, the Chairman commented. The key was that such an investigation be undertaken from that perspective--the systemic implications--and not only because the Fund needed to secure enough resources to deal with the arrears problem.

Mr. Dawson said that compulsory withdrawal had not been a very effective deterrent, because it had not been used. Suspension, by coming earlier in the period of arrears, might be a more effective deterrent because there was a better chance that it would in fact be used. Moreover, suspension could be reversed, whereas he could not easily contemplate a reversal of a compulsory withdrawal.

Mr. Arora stated that he would agree with the Managing Director that deterrence must be a strong element in strengthening the arrears strategy. He agreed with Mr. de Groote that a deterrent, to be effective, must be real. He had no basic problem with the sequence and timing suggested by the Managing Director, but the proposed timetable should be seen as indicative, rather than mandatory. The staff and management should leave room for flexibility in reviewing individual cases. Automaticity would take away the initiative and discretion of the Board, which would not be desirable for the Fund's image.

He recalled that Mr. Nimatallah had recommended that the Fund should be harsh in the beginning, so as to be kind later on, Mr. Arora remarked. However, if the Fund came to pressure members too much in that regard, the purpose it had in view might not be well served.

He agreed with those who heartily endorsed the Managing Director's idea that the question of the amendment of the Articles should not be pursued at present because of the likely difficulties, and the fact that a consensus on that point had not yet been achieved, Mr. Arora concluded. He did not mean to imply that he saw no merit in discussing the idea, however.

Mr. Kabbaj said that he also agreed with the Managing Director's proposal regarding measures of deterrence, and on the sequencing and on timing. However, like Mr. Arora, he would wish that some flexibility be left to the Executive Board in the framework described, to allow the application of judgment to the decisions. He would also suggest that the timing be seen as indicative, and not to be followed slavishly in all cases.

It might not be fully practicable to attempt to reinforce the Fund's preferred creditor status, Mr. Kabbaj went on. Some of the creditor countries had indicated that that might not be the best way to go at present. He wondered whether other creditors, including commercial banks, would restrain their claims on debtors in favor of the Fund.

One of the merits of the Managing Director's proposals was their immediate feasibility, Mr. Kabbaj concluded. If the Board pursued an amendment of the Articles to provide for the suspension of voting and related rights of membership it risked delaying the quota increase. He agreed with what Mr. Dawson had said about the virtues attached to a reversible action like suspension, but he was not sure that instituting it would be worth the time it would undoubtedly take.

Mr. Dawson said that he wondered if the Fund were not something of an anomaly given the fact that most organizations similar to it--the Islamic Development Bank and the International Fund for Agricultural Development, for example--had provisions on suspension of membership, or something close to it. He would be extremely disturbed to learn that there was a lack of consensus in favor of an amendment to that effect, given that other organizations had such a provision.

Mr. Kabbaj said that he had referred chiefly to the questions of feasibility and timing in connection with an amendment, not the lack of consensus. He adhered to the Managing Director's suggestion that if the Fund's new procedures for dealing with arrears were found not to be working, an amendment of the Articles then be considered.

Mr. Dawson said that nothing prevented the Board from pursuing the other elements in the Managing Director's statement at the same time as the ratification of an amendment was proceeding in national capitals. Suspension completed the range of weapons to deal with arrears in the Fund's arsenal. He feared that if that weapon were not agreed to at present, the same issues would arise at the time of the Tenth General Review of Quotas.

The Chairman said that he indeed wished to preserve the possibility of moving to compulsory withdrawal, if that became necessary in a particular case, during the time that an amendment on suspension was being ratified in national capitals.

Mr. Finaish made the following statement:

> Regarding the issue of suspension, as the Managing Director suggested, it may well be that the totality of the package, in all its three elements, will obviate the need to go through the highly exceptional process of amending the Articles of Agreement just to allow for the suspension of voting rights. Obviously, the Board could have recourse to amendment in the future if it is concluded that such a step is useful and necessary.
>
> On the timetable proposed for declaring a member uncooperative and for initiating procedures for compulsory withdrawal, we continue to believe that a case-by-case approach is warranted. It would not, in our view, be useful for the Board to put itself in the straitjacket of a rigid timetable. We would have less difficulty, however, with benchmarks or notional periods which management and the Board would treat in a flexible way depending on the circumstances of the case.
>
> On the question of preferred creditor status and seeking the cooperation of other bilateral and multilateral creditors in order, among other things, to make it more painful for the uncooperative member to remain uncooperative, we share the sentiment

behind the Managing Director's suggestion. However, we continue to feel that this is a very sensitive area where caution is necessary. I suspect that much of the remaining flow of resources to a number of uncooperative protracted arrears cases is specific in nature--food aid, project financing and the like--as opposed to general balance of payments assistance. The Fund should certainly not appear to be pressuring other creditors and donors to cut off all assistance to the country, even when that country is uncooperative with the Fund. The living conditions in some protracted arrears countries are so difficult that any impression that the Fund is not sensitive to the plight of the population in those countries would be counterproductive.

Obviously, this is not the situation in all cases, and in some instances we may have a country that chooses maliciously not to repay the Fund. I am not talking about such cases. My concern is more about countries which, for domestic or exogenous reasons, are facing extremely difficult living conditions. I do not think that in such cases the Fund should appear to be making things even more difficult for people who are barely able to attain subsistence, and sometimes not even that.

On the question of quota subscriptions of members in arrears, we have some sympathy with Mr. Kafka's remarks. At the very least, we should spell out more clearly that favorable consideration would be given to an extension if justified by the situation of members who are cooperating with the Fund. The sentence on this issue seems to say less than that. In our view it should read something like this: " An extension of the period of consent or payment would be favorably considered if warranted by the position of members with overdue obligations...."

Mr. Mawakani said that the Managing Director's statement was a good base for the discussion. On measures of deterrence, he had no difficulty with the sequencing and timing suggested in the statement. On the question of suspension of voting and related rights of membership, he agreed that that possibility should be kept in mind, but perhaps it should be discussed later because suspension would require an amendment of the Articles of Agreement. Since the issue of suspension and the quota review were being linked--a link with which he had not really agreed, but with which he was willing to go along for the sake of furthering the quota increase--some balance should be reached, with the quota review being pursued before the amendment of the Articles.

With respect to enhancing the Fund's preferred creditor status, sometimes, in order to have a Fund-supported program, financing assurances from other official agencies or institutions were needed, Mr. Mawakani pointed out. If their participation was needed, it would be inappropriate for the

Fund to require them to forgo repayment to enable the Fund to be repaid. That did not represent a balanced treatment between the Fund and those institutions. He therefore had some reservations about the usefulness of that provision.

Mr. Filosa stated that the Managing Director's statement was a good basis for the Board to take decisions, and he was in full agreement with it. He did not believe that the way the operation of the timetable of measures had been described implied that the Board would be denied flexibility in applying it in individual cases. Deadlines were clearly useful, and he supported strengthening them.

He was in favor of an amendment of the Articles to implement a provision on suspension of voting and related rights of membership, Mr. Filosa continued. He supported Mr. Grosche's view that the time had come for the Board to pursue the amendment actively.

He did not believe that additional time should be given to members to enable them to appreciate the full ramifications of a step such as compulsory withdrawal, Mr. Filosa concluded. Countries in arrears were to be given a number of favorable financial incentives through the rights approach to become current with the Fund, and it was only fair that those advantages be balanced with the threat of compulsory withdrawal.

Mr. Yamazaki stated that the deterrent measures the Fund ultimately chose to adopt should be compatible with the Fund's cooperative character. At the same time, those measures should be strengthened, in order to protect that cooperative character. He basically agreed with the Managing Director's statement. He agreed with Mr. Nimatallah that, to be useful, deterrent measures should be credible, and in that connection he supported an amendment of the Articles to put in place a provision on suspension of voting and related rights of membership.

Mr. Nimatallah observed that the importance of suspension lay in the fact that, by influencing the readiness of others to provide financing to the country in arrears, it would bring the country in arrears to the day of reckoning. In that respect, suspension would secure greater cooperation from the world at large.

Perhaps a test case of compulsory withdrawal could be considered, Mr. Nimatallah commented. In his judgment, Liberia was ripe for such an action.

The Chairman said that he would not recommend taking action simply for the purpose of a test, especially where a matter as serious as withdrawal from Fund membership was concerned.

Mr. Dawson observed that one of the problems he saw in the Fund's present arrears strategy was that even countries like Liberia, which had been declared ineligible to use the Fund's resources long ago, still had not been declared noncooperative. That argued strongly in favor of guidelines and a timetable for the implementation of deterrent measures, in his view.

Mr. Nimatallah said that the Board could act in the case at any time, and that a timetable was not really needed. The Board already had the flexibility to deal with the situation if it wished to.

Mr. Enoch remarked that he was not certain whether accelerating the process of compulsory withdrawal was inconsistent with also proceeding on suspension of voting and related rights of membership. His chair supported an amendment of the Articles to provide for the possibility of such suspension, even though by the time it became effective, the number of countries it might be applied to might be smaller.

The Director of the Exchange and Trade Relations Department stated that the staff believed that the moral hazard problems inherent in the current arrears strategy could be dealt with, and the strategy strengthened, only if the deterrents were themselves strengthened. Moreover, the current 11 cases of arrears would not be solved by special action on a case-by-case basis. Moving toward an agreed timetable for the implementation of deterrent measures would not commit the Board to it; the Board could still agree in any particular case not to abide by a previous decision. The benefit of such a timetable, however, was that it would, in effect, shift the burden of proof onto those who might wish to depart from the established schedule.

The Chairman added that Mr. Posthumus's proposal would also allow the Board more flexibility, in skipping steps in certain cases.

The Directors then turned to the section of the Managing Director's statement on the financing of Fund-monitored programs.

The Director of the Exchange and Trade Relations Department said that the three parts of the Managing Director's statement had been addressed to different types of Fund members. The section on preventive measures had been directed toward all countries except the 11 current cases of arrears. The section on deterrents was addressed to the 11 cases of arrears--perhaps with some grandfathering, as Mr. Dawson had suggested--and the rest of the membership. The section on the financing of Fund-monitored programs was directed solely to the current 11 arrears cases.

Mr. Enoch made the following statement:

> Looking first at the question of how to clear members' arrears at the end of the Fund-monitored program, it seems to be broadly agreed that the rights approach will have a key role to play. Some details have still to be resolved. For example, rather than bending the current rules on access, I would prefer to see Fund-monitored programs lengthened, perhaps to four years in

exceptional cases. Clearly it will be necessary, too, to determine the appropriate repurchase period for disbursements made under the rights approach. While the standard three- to five-year period may bring with it a number of new problems, I doubt that it would be appropriate to go beyond a four- to ten-year repurchase period such as that under the extended Fund facility.

Perhaps the most important remaining issue under the rights approach is whether the initial disbursement of Fund resources, at the end of the Fund-monitored program, should inevitably be a disbursement from the General Resources Account or whether concessional resources could also be used. My authorities firmly believe that for structural adjustment facility or enhanced structural adjustment facility eligible members, financing under the rights approach should come through disbursements of concessional resources, either enhanced structural adjustment facility resources or funds from the Special Disbursement Account.

There are two arguments against the use of structural adjustment facility or enhanced structural adjustment facility resources in this connection. The first relates to equitable burden sharing. Since the United Kingdom is the largest grant contributor to the ESAF Trust, I can well appreciate this concern. But the only serious argument against use of that facility that has been deployed in recent Board discussions is that it might reduce the security underlying the claims of lenders to the Trust. However, as the Managing Director stressed in his statement, the Fund has already given a solemn undertaking to stand behind the ESAF Trust. Like the Managing Director, therefore, I would urge the lenders to the enhanced structural adjustment facility to recognize that their claims are secure and that if they continue to insist on the use of General Resources Account resources to finance the rights approach, this will simply store up trouble for the future. Nonconcessional borrowing may cause a member difficulties in debt servicing after arrears have been cleared, and so may be inconsistent with steps being taken under the preventive elements of our arrears strategy. Moreover, it might necessitate a more explicit provisioning policy than the Board has so far contemplated.

Indeed, this corollary of using General Resources Account resources to fund the rights approach is now candidly recognized in the Managing Director's latest proposals. Whereas previously an extension of the current burden-sharing arrangements was seen as one potential source of finance for helping to sustain members during the period of their Fund-monitored programs, under these latest proposals additional money from burden sharing would go into a special reserve designed to stand behind disbursements under the rights approach.

Now, while all of us around this table would agree that our central task is to strengthen the financial position of the Fund, it is equally clear that there are a number of different approaches to achieving this objective. One way will be to try to help cooperating members to clear their arrears by devoting the membership's scarce resources to encouraging the successful implementation of Fund-monitored programs. A second approach would be to devote these scarce resources to building up the Fund's financial reserves so that if members in arrears are unable or unwilling to clear these arrears, the Fund can withstand the financial cost of write-offs consequent on expulsion. Scarce resources cannot be used twice, and in the end the Board will need to decide which of these two approaches is the one to adopt or whether both can be financed, given the resources available.

My authorities see the case for building up the Fund's reserves by creating a new special contingent account. However, before they could sign up to this, they would need considerably more information on the precise modalities of how the account could be used. For example, would the account involve specific provisions against loans extended under the rights approach, or would it be in the nature of a general reserve? Would the amounts in the account also stand behind existing arrears in the event that one or more of the current arrears members were expelled from the Fund? How would this account differ from the existing Special Contingent Account and the Fund's General Reserves?

Even if the proposal to set up a new special contingent account may be acceptable in principle, my authorities have considerable difficulties with the proposed sources of finance in practice. If I understand the Managing Director's statement correctly, the new account will be financed from three sources: from an asymmetric extension of burden sharing; from the repayment of deferred charges already collected under burden sharing; and from voluntary additional contributions by members considered at present to be contributing too little under the existing burden-sharing arrangements. This proposal involves considerable problems.

First, my authorities regard the principle of symmetry as fundamental to the burden-sharing arrangements. These arrangements were originally put in place to prevent the Fund's debtor members from bearing, on their own, the entire burden of deferred charges. At that time the Fund's creditor members agreed that they would mitigate the burden on the debtors by themselves sharing this burden in a symmetric manner. Proposals now to make the creditors go further would risk unraveling the fragile consensus that has held the current arrangements together for the last few years. It would also undermine a key objective of the strengthened arrears strategy, which is to bring home to the whole membership, to creditors and debtors alike, the full cost of arrears to the institution.

Second, the proposal to earmark previous contributions under burden sharing to the new account would eliminate the possibility that these contributions could in some way have been recycled in order to reduce the amounts to be cleared through the rights approach at the end of the Fund-monitored program.

Third, the proposal to supplement the current burden-sharing arrangements with an additional voluntary scheme raises a number of very difficult issues. First, as many Directors have emphasized, the voluntarism of this proposal immediately brings with it a host of problems. Second, any additional contributions would almost certainly score as public expenditure and would therefore create difficulties for the national treasuries of many members. Third, and perhaps most important, it is not clear on what basis the proposal stands.

Certainly it is true that some members contribute more to burden sharing than others. Among creditors, for example, those members receiving the most remuneration from the Fund also, by definition, contribute the largest amount to burden sharing. However, the real question is why this arises. As the Managing Director's statement implies, answering this question requires taking fully into account the fact that some members are paying less toward burden sharing because they are contributing more to the Fund itself in the form of interest-free resources. The United Kingdom, for example, has the lowest remuneration norm of any Fund member, and, at current interest rates, the United Kingdom's unremunerated position implies forgone interest of over SDR 60 million per annum. To put this in context, if the United Kingdom was fully remunerated, the rate of charge faced by debtor members would need to rise by nearly 1/2 a percentage point to maintain the Fund's net income target unchanged. This forgone interest, of course, is given up forever. Amounts collected under burden sharing, by contrast, are to be repaid to contributors when the arrears problem has been resolved. In these circumstances, any attempt to put political or moral pressure on members with relatively low remunerated positions to increase their contributions to burden sharing would be quite likely to fail.

One final point on this proposal. Even if additional contributions were forthcoming--for example, from members currently making no contribution to burden sharing--it is not clear that it makes sense to use the additional amounts to compensate the debtors rather than to augment the total pool of available resources. If the bulk of the SDR 300 million to be generated from additional voluntary contributions were paid to debtor members, this would seem to leave the latter, as a group, paying less toward burden sharing than they do at present. This would seem to be perverse at the present time when all members are being asked to intensify their efforts to resolve the arrears problem.

Let me turn to the question of the financing of Fund-monitored programs. The Managing Director's statement rightly confirms that the primary responsibility for meeting Fund obligations as they fall due during the period of a Fund-monitored program must remain with the cooperating members themselves. It also reiterates the key role support groups and consultative groups will continue to play in mobilizing external assistance in support of members' adjustment programs. But the question remains, to what extent is additional assistance required and, if so, from what source and through what vehicle should this additional financing come?

To answer the first of these questions we would need to have a clearer view, on a case-by-case basis, of members' financing requirements over the medium term. The Board would also need some further examination of outside sources of financing, for instance, through sequential clearance of arrears with the World Bank. And, of course, it is very difficult to obtain even rough estimates of the likely magnitudes involved until Fund-monitored programs have been negotiated for each member.

Following the analysis in the Managing Director's statement, it seems that for at least some of the protracted arrears cases under discussion, some additional financing will be required if the support group strategy is to bring about the successful conclusion of members' adjustment programs. The Managing Director's statement provides two suggestions on where these additional resources might come from. I have to say at the outset that my authorities consider neither of these proposals acceptable.

The first proposal involves disbursements into arrears. As such, it breaches a fundamental principle which my authorities believe should, and indeed must, be observed. The fact that the disbursement would not involve the use of General Resources Account resources does not and cannot disguise the essence of the proposal.

The second suggestion--allowing members in arrears to use local currency to repay forthcoming charges--would amount to rescheduling through the recapitalization of interest. As the Managing Director notes, this proposal would be essentially cosmetic--charges would remain outstanding, the Fund's financial and liquidity position would remain unchanged, and burden sharing would still be required.

If neither of these routes is attractive, the question arises, what other alternatives are there? This brings me back to the central issue I raised earlier. Should the scarce resources at our disposal--the proceeds of enhanced burden sharing--be used to strengthen the Fund's reserves or to help members clear their arrears? At present the proposals the Managing Director has outlined seem slanted in favor of the former objective, in part because they assume that future disbursements of General Resources Account resources should be collateralized. As I have suggested earlier, however, adopting this framework may make the question of resolving arrears considerably more difficult.

In response to a question from the Chairman, Mr. Enoch added that the alternative to using General Resources Account resources to fund the disbursement of rights earned following the conclusion of the Fund-monitored program was to use enhanced structural adjustment facility resources. To use General Resources Account resources for that purpose would worsen the Fund's position, and collateral would be needed. Enlarged burden sharing would be needed to provide the collateral, so that it would not be available to members during the Fund-monitored program itself. The argument that because the Fund itself stood behind structural adjustment facility resources justified the use of those resources for funding rights could be applied with even greater force to using enhanced structural adjustment facility resources, in his view.

The Chairman said that that depended upon whether or not such use was agreed upon by contributors to the ESAF Trust.

Mr. Dawson made the following statement:

The Managing Director's proposal for financing a rights program suffers from a number of serious shortcomings. First, there is no provision for a contribution by the arrears country to covering the cost of a problem created by the failure to meet its financial obligations. The U.S. proposal to mobilize an amount of gold equivalent to the gold subscription of the arrears country and to require that any gold sold be replenished would provide such a contribution. It would also generate substantial resources that could reduce the upfront costs of members fulfilling their obligations, particularly as the Managing Director's proposal is underfunded and raises serious equity problems. We are therefore surprised that the Managing Director has so readily dismissed a proposal which a number of Executive Directors expressed a willingness to consider.

The Managing Director's financing proposals raise a number of difficult technical and policy problems. In this connection, we would appreciate some clarification of how burden-shared resources would be utilized under the rights approach. Would they be added to reserves to protect the Fund's financial position and thus serve as a backstop for new Fund lending from quota resources under the rights approach? Or would the additional resources generated by burden sharing be used directly to finance the rights loans? My authorities are opposed strongly to the use of quota resources to finance rights loans. Furthermore, it is our understanding that Mr. Yamazaki, and possibly other Directors, may have legal problems with the retention of previously burden-shared resources in the General Resources Account if this were structured in a manner that created the perception that a loan was being extended to the Fund. This problem could become especially acute if all participants in the burden-sharing arrangements did not provide the required consent, and/or special arrangements were not in place to enssure that the balances of burden-shared resources were returned even if the arrears country failed to repurchase the rights purchase. It is also our understanding that use of the old burden-sharing resources would result in a reduction in the Fund's general reserves by the same amount, and thus weaken the Fund's financial position. We continue to believe that the present symmetrical arrangement for distributing the cost of burden sharing is an integral part of the agreement, and should be maintained. While we have no objection to voluntary loans to facilitate a quota-based distribution, we remain skeptical that such an approach is practical, and see no reason why the loans should be used to reduce the burden only for debtor countries. In those circumstances, it seems to us that mobilization of a limited amount of gold would reduce substantially the problems of relying on burden sharing as the principal means of financing a rights arrangement.

We understand the Managing Director's concern regarding the feasibility of having the support groups and the arrears country be responsible for the financial burden of ensuring that the country remains current during the Fund-monitored program. However, we could not agree to either local currency payment for overdue charges or the further accumulation of arrears as possible solutions. A local currency payment would be tantamount to a rescheduling, and further arrears accumulation runs contrary to the underlying premise of the entire arrears strategy--that existing arrears should be reduced and new arrears prevented. It is also not clear that the proposed SDR 600 million in structural adjustment facility resources is fully available, since a number of countries are in arrears on Trust Fund repayments amounting to more than SDR 166 million. Therefore, we believe that the arrears country should have the primary responsibility for remaining current on its obligations during the Fund program.

The Director of the Exchange and Trade Relations Department said that the amounts of deferred charges under the burden-sharing arrangements might be retained--on a voluntary basis--once the Fund was in a position to repay them, in order to strengthen the Fund's reserve position so as to provide greater confidence for a new, formal Fund-supported program following the Fund-monitored program and the clearing of arrears. The staff had not envisioned those amounts as constituting the financing of a separate facility.

Mr. Nimatallah stated that the member in arrears should be responsible for meeting current charges as they fell due during the period of the Fund-monitored program. Support groups should be responsible for bearing the cost of the program itself. Following the successful completion of the Fund-monitored program and the clearance of all arrears to the Fund, the formal Fund-supported program should be financed with a combination of General Resources Account resources--on the standard terms--and enhanced structural adjustment facility resources--on concessional terms.

The idea of providing a backing for the General Resources Account appealed to him, Mr. Nimatallah continued. Perhaps amounts flowing back to the Fund in repurchases could be placed in the Special Contingent Account rather than in the General Resources Account for that purpose. The Special Contingent Account would be bolstered, and the need for creating a second such account eliminated. Because it would be seen as strengthening the Fund's position, it would be met with approval by the External Auditors.

He had an open mind as to whether or not enlarged burden sharing should be symmetrical or asymmetrical, Mr. Nimatallah went on. An asymmetrical burden sharing would bring in smaller amounts than was desirable, however. On the other side of the argument, asymmetrical burden sharing would help the debtor countries, with which objective he could agree as well.

The reference to the fact that the international community and the member in arrears would be responsible for meeting charges falling due to the General Resources Account during the period of the Fund-monitored program should be moved to the section of the Managing Director's statement which addressed the financing of the formal program, Mr. Nimatallah pointed out.

Use of Special Disbursement Account or structural adjustment facility resources should be reserved for the payment of charges only when the member really faltered, despite its best efforts to arrange the payment of charges, Mr. Nimatallah concluded. Even in that situation, he was unsure of the type of mechanism that could be created to allow the Fund to make disbursements while the member was still in arrears. Perhaps, as the Director of the

Exchange and Trade Relations Department had suggested earlier in the meeting, a "super" structural adjustment facility which would be slightly different from the usual structural adjustment arrangement might be envisioned. That notwithstanding, the objective would be to begin adjustment and reform without the use of Fund resources.

Mr. Grosche stated that the Fund needed to make it clear that the new measures would be restricted to the 11 current cases of arrears. Members which fell into arrears in the future--which hopefully would not occur because of the improved deterrent measures--should have no expectation whatsoever that they would be treated similarly.

The Managing Director had suggested a normal accumulation period of two to three years under the rights approach, Mr. Grosche recalled. He was not sure whether that would be sufficient in most of the cases the Fund had to deal with. He would prefer to have a normal period of three years, but could allow for some flexibility in both directions. In cases in which prior actions had been taken by the member, he doubted whether the Fund should allow for an initial acquisition of rights upon endorsement of a Fund-monitored program compared with existing policies. The Fund was already prepared to go far out of its way in dealing with protracted cases of arrears, and could be blamed for treating members unequally in granting too many favors in that respect. After long periods of a bad track record, it would be quite normal for the Fund to expect signs of goodwill marking a new era of economic policies. A member with a bad track record should not expect to be given additional rewards for prior actions.

There should be some guidelines as to how to treat members' accumulated rights if, later on, performance criteria were not observed, Mr. Grosche pointed out. He agreed that the member should be allowed to retain its previously accumulated rights temporarily, but limitations were needed. A guideline could prescribe that a country which had not brought the program back on track after, say, two quarters, would lose one quarter's rights in the third quarter, and so on.

On the financing of the rights approach, he agreed with the establishment of a further special contingent account to be funded through an extension of the burden-sharing arrangements, Mr. Grosche continued. He considered the principle of symmetry in burden sharing to be very important, but he would be ready to deviate from it to the extent that funds could be raised through the amended Arora proposal.

Financing of the Fund-monitored program was a particularly difficult issue, Mr. Grosche commented. He was grateful that the Managing Director had not pursued further the idea of disbursing enhanced structural adjustment facility resources in cases in which arrears persisted. His U.K. colleagues were fortunate in being able to contribute only budgetary resources to the interest account of the ESAF Trust, and consequently did not need to be concerned so much about the security of their funds than others. There was not much sense in talking again and again about using the enhanced structural adjustment facility for that specific purpose, because, in order to make it work, unanimous approval of creditors of a change in the instrument would be required, and that was not going to happen. Even assuming that it were possible, the Fund would not make use of it in any case, because, after becoming current, a country would still need concessional resources, and the enhanced structural adjustment facility was the appropriate instrument to support continued structural adjustment under regular Fund programs. The Fund should not put all its eggs in one basket, using all its resources to finance a Fund-monitored program.

He took the Managing Director's arguments making a distinction between General Resources Account resources and the Special Disbursement Account with respect to the question of using structural adjustment facility resources very seriously, Mr. Grosche remarked. Nevertheless, he continued to be concerned about the intention to disburse money originating in the Fund into a situation of arrears. He was afraid that, soon after introducing such a scheme, proposals would be made to use general resources for a similar purpose. How could it be made sufficiently clear that the Fund was sticking to its principle of not using general resources in cases of arrears? How could the Fund keep from opening Pandora's box if it went in that direction? Moreover, assuming that the Fund did so, what would happen if slippages occurred in the Fund-monitored program? As far as the accumulated rights were concerned, ideas had been put forward which would help to protect the Fund; but where would the Fund's protection be after structural adjustment facility resources had been disbursed? He wondered whether it would help if the Fund allowed a country to delay the payments on a certain amount of charges, while earmarking structural adjustment facility resources for those payments, with the understanding that those resources would be disbursed only once the Fund-monitored program was on track. If the program went off track, of course, then the country would remain in arrears and the structural adjustment facility resources would not be disbursed.

He regretted that he was not able to lend his support to the idea of using structural adjustment facility resources, Mr. Grosche concluded, but he would keep in touch with his authorities with a view to deepening his understanding of the implications of such use.

Mr. Enoch asked Mr. Grosche whether Mr. Grosche's fears in that respect might not be assuaged by the indication in the Managing Director's statement that, in the case of serious and protracted repayment delays on enhanced structural adjustment loans, the Fund would take whatever actions were necessary to ensure that lenders to the ESAF Trust were repaid on time. Moreover, he wondered whether explicit reference to mobilizing the Fund's gold in such a set of circumstances would be useful. Lastly, he wondered what Mr. Grosche's solution would be in the event a medium-term analysis demonstrated that a country would be unable to make repurchases under a formal Fund program if the resources were nonconcessional.

Mr. Grosche said that an 85 percent majority of the total voting power would have been required to insert a provision in the ESAF Trust instrument to allow for a gold backing, and he recalled that the U.S. Treasury had been extremely reluctant to go along with the idea. The fact that the Fund had committed itself to repaying lenders to the enhanced structural adjustment facility on time in the case of prolonged repayment difficulties in respect of loans under that facility was some comfort, but the key issue was that only a few lenders to the ESAF Trust bore most of the risks. In that connection, it needed to be borne in mind that the United States was a contributor only to the interest account of the ESAF Trust. His authorities were not prepared to see enhanced structural adjustment facility resources disbursed into a situation of arrears; they were ready and eager to see them disbursed once the arrears were cleared, when a track record had been established, when further adjustment could be expected, and when the medium-term viability of the balance of payments was in view.

Mr. Dawson asked whether the fact that the Fund was contemplating using its general resources to fund arrears would not be seen by Mr. Grosche's monetary authorities as calling into question the security of their reserve position in the Fund, notwithstanding the burden-sharing arrangements.

Mr. Grosche said that the Fund's general resources were impaired because of arrears, and the liquidity position was impaired as well. Because of the maintenance of value provisions, the Fund's assets--and members' reserve positions--were not impaired. Honoring "rights" out of the General Resources Account in no way impaired the Fund's general resources. An extended burden-sharing arrangement to provide an additional backing for those resources was all to the good, but was not crucial. The crucial point was that following the period of the Fund-monitored program and the encashment of accumulated rights, the Fund would have improved its claim on the country, which was what his authorities were seeking.

Mr. Enoch said that he wondered whether it would not be preferable for the Fund to grant enhanced structural adjustment facility resources to a country which could not meet its financial responsibilities to the Fund with other than concessional resources, than for the Fund to force the country to withdraw. He wondered whether Mr. Grosche would withdraw his objections to using enhanced structural adjustment facility resources if the Fund managed, despite the special majority of 85 percent of the total voting power that would be required, to secure some contingent gold backing for the ESAF Trust.

He also wondered whether the Fund would really be changing the nature of the enhanced structural adjustment facility by employing it in the context of the rights approach, Mr. Enoch went on. Perhaps if a bridge loan were used to clear arrears, followed by front-loaded access under the enhanced structural adjustment facility, the terms of the enhanced structural adjustment facility would be met. On a related point, he wondered whether the ESAF Trust instrument would have to be changed--which would require unanimity of ESAF Trust creditors--or whether it could instead be divided into two parts, the second part pertaining to those members which would agree to use of ESAF Trust resources in the rights approach under certain circumstances, and the first part reserved to those members which did not so agree.

The General Counsel said that there was no prohibition on the use of enhanced structural adjustment facility resources if an eligible member was not in arrears to the Fund.

Mr. Enoch commented that access under the enhanced structural adjustment facility of 250 percent of quota, and, in exceptional cases, 350 percent of quota, might not be adequate in all cases, but it might be significant from the point of view of the Fund's involvement. A bridge loan organized with other resources could be used to clear arrears, after which an enhanced structural adjustment arrangement could be set in place.

Mr. Grosche said that the same problems arose in using resources from the enhanced structural adjustment facility to--in effect--clear a bridge loan as in financing the bridge itself from those resources. The enhanced structural adjustment facility had not been created with that in mind, and the principle was the same. That facility had been created in order to finance the restructuring of economies over a protracted period--three years. Taking into account the tremendous burden that would be placed in countries just emerging from arrears--not least stemming from the burden of their previous commitments, including the need to refinance the rights--to pay future charges, and to support subsequent adjustment programs, he believed that the Fund would be taking a great risk in disbursing resources to such countries all at once, without reserving any for later on. By the second or third year, the same problems might have re-emerged. That notwithstanding, he could agree to look at front-loading on a case-by-case basis, even though he wished to stress his reservations about it.

The Chairman said that he understood Mr. Grosche's point about the need for the Fund to stay involved with countries previously in arrears until their recovery was firmly in place. He saw the logic of following the disbursement of General Resources Account resources with resources under the enhanced structural adjustment facility, but he believed there was an equal logic in disbursing resources the other way around, because the concessional resources would be available to the country at a time when it was weaker, and might not be able to bear the burden of the charges on general resources.

Mr. Grosche stated that the arrears problem was a problem of the entire international community, and the entire community needed to address it. The enhanced structural adjustment facility had been established through contributions from only a few members of that community for a specific purpose--not arrears, but structural adjustment. He did not wish to see the risks associated with arrears being transferred from the international community to the few contributors to the ESAF Trust.

It might be expected that the exertions of the support groups, consultative groups, and other donors might naturally abate following the period of the Fund-monitored program, taking into account the tremendous efforts that they would need to have undertaken in that regard, Mr. Grosche pointed out. That being said, he believed that it would be wise to keep something in reserve for the period following the clearance of arrears, when support for the country would still be needed, but when the country's previous supporters may have retired from the field. To front-load resources under such circumstances might mean that the country was left with almost nothing at the end.

If the international community had agreed to back loans provided by a few from the enhanced structural adjustment facility with gold, there would be almost no need for that facility, and the loans might have been placed in the General Resources Account, Mr. Grosche observed. The possibility of a gold backing had not been considered at the discussions leading up to the creation of the facility. The enhanced structural adjustment facility had been seen then as a separate window for which the Fund had no responsibility, other than the moral commitment to which Mr. Enoch had already referred. If it were to be backed with gold, it would almost be an instrument within the General Resources Account, in his view.

Mr. Enoch said that he recalled that the discussions for the enhanced structural adjustment facility had considered a gold pledge. The compromise wording to which he had referred meant much insofar as the Fund's responsibility vis-à-vis the facility was concerned, in his view. A gold pledge might strengthen that responsibility, but would not alter its nature.

Mr. Grosche commented that specifically including a gold pledge for the enhanced structural adjustment facility loans might change the position of his authorities, as it would change the facility. Front-loading of enhanced structural adjustment facility loans might be discussed further in that case, although he continued to have reservations about them, for the reasons he had mentioned already.

Mr. Nimatallah remarked that Mr. Grosche's concerns showed how dramatically the arrears problem had damaged the Fund. Managing the Fund was made increasingly difficult as the problem of arrears persisted.

The discussion of the use of resources under the structural adjustment facility should be separated from that on use of enhanced structural adjustment facility resources, Mr. Nimatallah continued. He was certain that Mr. Grosche would agree with him that once the arrears had been cleared, after settling the bridge loan from General Resources Account resources, financing a Fund-supported program through the enhanced structural adjustment facility should present no procedural problems. However, use of structural adjustment facility resources for that purpose needed to be examined further before proceeding with it.

The Fund had made a pledge to Saudi Arabia to inform Saudi Arabia before it used gold to back the enhanced structural adjustment facility, Mr. Nimatallah pointed out. In his view, the real collateral which the Fund had at its disposal in that respect was not gold, but the quotas as represented in the general resources; that was where the Fund's strength lay.

Mr. Dawson said that, assuming the staff's approach was adopted, he wondered what would happen if a country failed to perform adequately under a Fund-supported program and went into arrears on its rights-financed borrowing from the Fund, taking into account the fact that the Fund's general resources would finance the rights, which would be backed by the burden-sharing arrangements and the Special Contingent Account. He wondered whether the burden-shared amounts would then be transferred to the general resources. If that were to happen, it would seem that Fund members would have an impaired asset vis-à-vis their reserve position in the Fund. If that was true, he would prefer using resources under the structural adjustment or enhanced structural adjustment facilities to general resources for the purpose of funding rights. The refinancing would also be less expensive, because of the concessional character of those resources; in that connection, use of gold would also serve to lower the expense to borrowers.

Mr. Grosche said that as long as the Fund did not increase its exposure in the General Resources Account, the maintenance of value provisions would ensure that the asset was not impaired, although the Fund's liquidity position would be impaired. Improving the Fund's financial position by shifting the financing of arrears to a few creditors was difficult to accept as long as the United States stayed basically uninvolved in that process. If the United States contributed according to its quota to such a refinancing out of extraordinary resources, other members might look at it differently. The real question was how the burden was being shared among creditors.

Mr. Yamazaki made the following statement:

> My authorities have not yet finalized their views. However, I would like to seek some clarification from the staff to help my authorities in their consideration of the proposals put forward in the Managing Director's statement.
>
> We have already expressed our support of the rights approach, as well as the strengthening of the burden-sharing mechanism to finance the rights approach. However, should all the resources created from both past and prospective burden sharing be used to finance the rights approach, and should a clear timetable and sequence for the deterrent measures, including compulsory withdrawal, be agreed, we would be concerned about the adequacy of the Fund's precautionary balances. The Fund's precautionary balances

have provided a safety net for unexpected adverse developments. Should the burden-sharing mechanism be used wholly for financing the rights approach, the appropriateness of the Fund's reserve may be in question. I would welcome the staff's comments on this point.

Mr. Enoch and other Directors raised questions on the proposed asymmetrical burden sharing. I share those concerns, and would welcome the staff's response.

The retention of deferred income has been proposed. I would like to ask the staff to elaborate on the procedure which individual contributors would follow to this end, since we would have to make sure that such a procedure itself would be legally feasible and acceptable under the laws of my country.

It is proposed to supplement the burden-sharing mechanism along the lines Mr. Arora has proposed. I would appreciate it if the staff could elaborate on the criteria by which a member country would be expected to make a contribution; in particular, I would like to know whether a member whose past contribution under the existing burden-sharing mechanism was less than 1 percent of the new quota, or a member whose past and prospective contribution under both the existing and strengthened burden-sharing mechanisms will be less than 1 percent of the new quota, are expected to be asked to contribute to an administered account.

Turning to the issue of financing the forthcoming obligations during the Fund-monitored program, the use of structural adjustment facility resources is proposed. So far, my authorities have not been in favor of providing such resources to countries in arrears to the Fund, even if they are engaged in a Fund-monitored program, and even though my authorities have fully understood that the Special Disbursement Account is separate and distinct from the General Resources Account and hope that the eight structural adjustment facility-eligible countries currently in arrears will clear their arrears and qualify for such loans in consequence. My authorities have been concerned that a loan under the structural adjustment facility to a country in arrears may give rise to misgivings in the international financial community. They have also been concerned that structural adjustment facility lending to a country engaged in a Fund-monitored program would not be regarded as the same as lending to a country which has cleared its arrears, since the country still engaged in a Fund-monitored program has not established its credibility. At this stage, since I have not received instructions from my capital, I have to maintain my previous position. However, for the sake of the consultation with my authorities, I would like to seek clarification on several points.

First, we welcome the staff's comments on enhanced structural adjustment facility conditionality. This chair has reiterated the need to improve the conditionality attached to such lending on the occasion of the review of the enhanced structural adjustment facility, as well as in individual cases. The staff's comment on its intention to review this issue would be helpful to me in consulting with my authorities.

Second, we would like to hear the staff's comment on whether the proposed preventive and deterrent measures will be applicable to structural adjustment and enhanced structural adjustment lending.

Third, we would welcome the staff's views on the fact that the creditor countries, which have contributed and will contribute to the burden-sharing mechanism more than their quota share, seem to overlap with the loan-contributing countries to the enhanced structural adjustment facility, and that there might be misgivings raised on the fair burden sharing among creditor countries.

Finally, we would like to ask the staff to provide us with a detailed projection of the ESAF Trust reserve, since the projected accumulation of the ESAF Trust reserve at the end of operations seems to be constructed on the assumption that enhanced structural adjustment facility borrowers will fulfill their obligation to the ESAF Trust fully. Furthermore, we would like to know what the staff assumes the cut-off date for the enhanced structural adjustment facility to be.

Mr. Landau stated that one of the most important points that had arisen from the Board's discussions was that a country would continue to need external financing following the Fund-monitored program. There were two ways of addressing that need.

In his view, the best solution would be to allow the repayment of charges in local currency, as Mr. de Groote had proposed, Mr. Landau continued. There was no question but that such repayment had an aura of rescheduling about it, but the idea had several advantages which should not be overlooked: First, no amendment of the Articles of Agreement would be needed to implement it. Second, it ensured that a country could keep current with its financial obligations to the Fund. Third, it would ensure that fiscal discipline was practiced inside the country itself, since it would be up to the national treasury to find the local currency to make the payments to the Fund. To the extent that a country was able to do so, payment of charges in convertible currencies would continue as well, with the local currency payment making up the remainder.

The second-best solution would be to mobilize enhanced structural adjustment facility resources to support a country following the Fund-monitored program, but he recognized that there was a problem with the Fund guarantee in that respect, Mr. Landau went on. He wondered whether the guarantee might be strengthened, and made more acceptable to some of his colleagues in consequence, if gold were explicitly mentioned in that connection.

He supported strengthening the burden-sharing mechanism, as Mr. Dawson had proposed, Mr. Landau noted, but his authorities did not believe that the burden on the debtors should be increased unduly. Therefore, he was in favor of an asymmetrical burden sharing, with a larger share being borne by the creditors.

He had strongly supported Mr. Arora's original proposal, as it clearly seemed to be more equitable than the present burden-sharing system, Mr. Landau concluded. Setting the standard level of contribution at 1 percent of quota seemed appropriate. Under the present proposal, the proceeds of that contribution would be used to reduce the burden borne by debtors through a lower rate of charge than would otherwise obtain. He believed that such a system might meet with even greater resistance in national parliaments than the original proposal, and he was therefore in favor of Mr. Arora's original one, under which the proceeds of the voluntary contributions would be used to help alleviate the burden on those countries in arrears which were cooperating with the Fund.

The Director of the Exchange and Trade Relations Department remarked that Mr. Yamazaki's question as to how contributions under burden sharing would be assessed, and whether or not a member's contributions under other mechanisms--such as to the enhanced structural adjustment facility--would be taken into account as well, served to highlight the difficulty in arriving at a clear-cut criterion for basing a judgment about the appropriate level of contributions. Since those contributions would be voluntary, perhaps the most appropriate way would be to leave the decision to the individual country. It would be hard to justify involving the Fund in the highly subjective business of deciding an appropriate level for voluntary contributions.

Programs supported by enhanced structural adjustment facility resources would continue to be subject to conditionality equal to that in the upper credit tranches, buttressed by front-loaded structural adjustment measures, the Director went on. The seriousness of the efforts that countries would need to make in that regard might be reflected in the fact that the staff had not been able to propose any new loans under the enhanced structural adjustment facility over the past several months.

The preventive and deterrent measures would apply to loans made under the structural adjustment and enhanced structural adjustment facilities, the Director confirmed. At present the enhanced structural adjustment facility was scheduled to lapse in November 1991; if that facility were to be used in the way proposed in the Managing Director's statement, it would have to be prolonged for from one to three years.

With respect to the matter of a gold backing for the enhanced structural adjustment facility, the Director of the Exchange and Trade Relations Department said that he would only note that the reason that facility had been created outside the General Resources Account had been in order to allow the Board flexibility in deciding which countries would be eligible to use it, without having to get tangled in the concepts and requirements of uniformity of treatment characteristic of--and properly so--the General Resources Account.

The General Counsel stated that, taking into account the domestic laws of a number of countries, the retention of contributions in the Special Contingent Account--itself a part of the General Resources Account--would be more acceptable from the accounting standpoint than their transfer to an administered account, which would not have the same Fund guarantee.

The Deputy Treasurer stated that the Special Contingent Account could not be reserved for any specific purpose. It would strengthen the General Resources Account, bolstering its resources against arrears, and it could back the encashment of earned rights, while serving as a general backing for the Fund as a whole.

If the Fund ceased to apply the provisions it had in place with respect to financing deferred income stemming from nonpayment of charges, they would have to be financed either against current income, and, if that were not sufficient, against the Fund's reserves, the Deputy Treasurer pointed out. The Fund's reserves would then show a declining trend, with an overall weakening of its financial position. Such an outcome would be something of an anomaly--a continued building up of the Special Contingent Account in conjunction with a general weakening in the Fund's general and special reserve positions.

Whether or not a second special contingent account would really be needed depended partly on the conditions of use the Board might decide to place on a second such account, the Deputy Treasurer concluded. From the point of view of perception, he believed that it would be advisable to retain the current Special Contingent Account, while creating a new one--with different operational specifications and restrictions--as Special Contingent Account-2.

The Executive Directors agreed to continue their discussion on the following day.

APPROVED: November 28, 1990

LEO VAN HOUTVEN
Secretary