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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 90/22

11:00 a.m., February 21, 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.	Zhang Z.
T. C. Dawson	
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	
	I. H. Thorláksson
	O. Kabbaj
G. Grosche	
J. E. Ismael	T. Sirivedhin
A. Kafka	L. M. Piantini
J.-P. Landau	J.-F. Cirelli
Mawakani Samba	
Y. A. Nimatallah	M. Al-Jasser
G. A. Posthumus	G. P. J. Hogeweg
K. Yamazaki	

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

Also Present

IBRD: E. R. Grilli, Economic Advisory Staff. African Department: M. Touré, Counsellor and Director; 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, 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. Munzberg, Deputy General Counsel; T. M. C. Asser, A. O. Liuksila. Research Department: 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. Personal Assistant to the Managing Director: H. G. O. Simpson. Advisors to Executive Directors: N. Adachi, M. B. Chatah, Z. Iqbal, J. M. Jones, K.-H. Kleine, G. Ladant, P. O. Montórfano, B. S. Newman, D. Powell, F. A. Quirós, A. Raza. Assistants to Executive Directors: G. Bindley-Taylor, B. A. Christiansen, E. C. Demaestri, S. K. Fayyad, B. R. Fuleihan, M. A. Ghavam, M. Hepp, J. Heywood, L. Hubloue, A. Iljas, C. Y. Legg, J. A. K. Munthali, D. Saha, J.-P. Schoder, G. Serre, Shao Z., J. C. Westerweel, Yang J.

1. <u>OVERDUE FINANCIAL OBLIGATIONS - STRENGTHENED COOPERATIVE STRATEGY</u>

The Executive Directors continued from the previous meeting (EBM/90/21, 2/20/90) their consideration of a statement by the Managing Director on overdue financial obligations to the Fund made at EBM/90/20 (2/20/90). They discussed the section of the statement dealing with financing of the Fund-monitored program.

Mr. Kafka stated that the section of the Managing Director's statement on financing of the Fund-monitored program had been drafted with great skill. However, he did not agree with the claim that in most cases it would be possible for members in arrears, with the help of support groups, to finance all aspects of a Fund-monitored program. The Fund's experience with the relatively modest requirements of Guyana had not been at all encouraging. He hoped for an improvement in the future in that respect, and that not only the country, but the support groups as well, would come forward with greater support.

He was not sure that he understood the paragraph in which it was stated that arrears countries and support groups would be expected to cover, at a minimum, repurchases and possible charges, Mr. Kafka remarked. He wondered whether it could be assumed that the financing of the Fund-monitored program as such would be expected to be covered as well; he supposed that that was so.

He agreed with the rights approach, and he would not insist on calling it rescheduling, Mr. Kafka went on. He also agreed with the need for an extended repayment period. He did not think that it would be helpful to the Fund to require the countries in question to have a subsequent program with the Fund, which would sound almost as if the Fund was offering a country a Fund financial arrangement as a punitive measure. After all, the country would have earned its disbursement--which would not even be a net disbursement--by carrying out its Fund-monitored program.

He also agreed to the phasing and waiver as suggested in the Managing Director's statement, but he would not like to subscribe to the creation of the second special contingent account based on the staff's modifications of Mr. Dawson's proposal, Mr. Kafka continued. Even the revised proposal would cost debtors and creditors dearly in terms of the spread over and below the SDR interest rate. The debtors' rate of charge would rise beyond 10 percent under present conditions, and, if the <u>Washington Post</u> was to be believed, interest rates in the United States would soon rise even further. The accumulated balances in the Special Contingent Account, structural adjustment facility resources, and resources under Mr. Arora's proposal should be used first.

With respect to the financing of other costs under the Fund-monitored programs, he was in basic agreement with the Managing Director on the idea of payment of charges in local currency, Mr. Kafka concluded. He would also be prepared to sell some of the Fund's gold if it became absolutely indispensable to do so.

Mr. Clark made the following statement:

We have supported the rights approach, and agree that it could provide a means for dealing with the large overhang of arrears in certain of the existing cases. As the Managing Director states, it would be a temporary policy to deal with special circumstances of a small number of the 11 countries currently in arrears. As we fully agree with the outline of the terms under which a country could accumulate rights, with the required conditionality that would be associated with the Fund-monitored program, and with the need for a subsequent program with upper credit tranche conditionality, I will not comment on those aspects of the Managing Director's statement.

We could agree to purchases from the General Resources Account once arrears have been cleared, although we would be prepared to consider the use of a limited amount of the Fund's gold. Regarding the proposals for strengthening the Fund's General Resources Account and the provision of backing for the large disbursements, we could go along with the suggestion for a further special contingent account, financed through burden sharing. Ideally, such burden sharing should be financed on as broad a basis as possible, as this would result in the most equitable treatment. However, there does not appear to be any practicable alternative to the current method of distributing burden sharing. We therefore could agree to a rate of remuneration equal to 80 percent of the SDR interest rate, and to limiting the increase in charges to half the amount generated by the change in the rate of remuneration.

Despite the attractions of Mr. Arora's proposal, it does not seem workable. We have considerable reservations about the proposal in the Managing Director's statement, based on the suggestion that the present burden-sharing mechanism could be supplemented through voluntary contributions from all members who are contributing less than the average under the burden-sharing formula. The Managing Director proposes that these contributions should be interest-free loans, and that the funds be on lent to debtor countries to reduce the contribution of countries which are contributing more than the average under the burden-sharing formula.

In our view, at least in the case of some potential contributors, it would not be appropriate to try and exert pressure for contributions. In fact, it might be counterproductive. As Mr. Enoch said, in many countries, such contributions would require budgetary appropriations. Given the need for fiscal restraint, this means that contributions could only come at the expense of other assistance, particularly assistance to support groups where it is going to be more seriously needed. Moreover, it would probably be more difficult to convince aid agencies, the budgets of which are likely to be affected, of the desirability of such contributions than of assistance to support groups. Thus, we not only have great doubts as to the amounts that could be raised in this way, but reservations about the proposed use of the funds, even though we recognize that burden sharing has significantly increased the charges paid by debtor countries. We wonder whether, instead, more effort should not be made to broaden support groups to include a greater number of countries, even if in some cases the contributions might be small.

We regard the need to ensure adequate financing during a Fund-monitored program as crucial to the success of the strengthened arrears strategy. This is true whether or not a country is able to clear arrears without accumulating rights. There is little point in putting in place an elaborate funding framework for clearing existing arrears, if none of the countries we are considering will be able to comply with a Fund-monitored program and remain current on obligations. The alternative to inadequate financial support will be increasing arrears, and, quite likely, discouragement on the part of the country, resulting in the end in the need for compulsory withdrawal. This is, of course, not the primary objective of this exercise.

In view of these considerations, and the likelihood that support groups will face very significant difficulties in raising adequate financing, we would support some limited use of Fund resources to ease this burden. Indeed, in our view, some contribution from the Fund is almost certainly necessary to ensure adequate financing, in part because it could be helpful in persuading countries that they should contribute. We would therefore favor using uncommitted resources of the structural adjustment facility. We would agree that disbursements to countries eligible for the structural adjustment facility should only be made when a country was meeting upper credit tranche conditionality under a Fund-monitored program. It is also clear that such a move would have to be viewed as exceptional, and confined to the limited group of countries currently with protracted arrears.

As the Managing Director noted, alternatives to the use of resources of the structural adjustment facility, if support groups are unable to find the necessary financing, are not particularly attractive. They would just add to the amount that needed to be refinanced. We would be opposed to acceptance of local currencies, which seems to be fraught with potential problems, in particular the risk of pressure to extend the use of local currencies and the raising of difficult issues for other multilateral institutions. It may be necessary, in the end, to accept a further accumulation of residual arrears, but this would clearly be a second-best alternative, both for the country and the Fund.

In response to a question from the Chairman, Mr. Clark said that his idea would be to use the Arora proposal for voluntary contributions in the support group process, rather than in the context of burden sharing. In effect, it would serve to broaden the support group process, and provide an indication of the level of contributions that might be appropriate from various donors. His concern was that there would be a limited supply of resources; if resources were requested for Mr. Arora's voluntary contributions, then resources available for support groups might be reduced. He wished to avoid a competition between the two approaches.

Mr. Filosa stated that Mr. Arora's proposal, which would request the entire Fund membership to provide resources on a voluntary basis to assure the viability of the new arrears strategy, clearly had an important role to play, and was a fundamental step in generalizing contributions for support groups, which had been difficult to secure heretofore.

In creating a machine as complex as the new arrears strategy, a degree of flexibility would be needed, Mr. Filosa continued. If one essential part was missing, the entire machine would break down. The great merit of Mr. Arora's proposal in that connection was that, by generalizing support group contributions, all pieces of the machine would be in place and operating; without it, he could not foresee success for the overall arrears strategy. That notwithstanding, an ex ante commitment from all the players to such contributions would be crucial.

He recalled that the Managing Director had observed that in some cases the old strategy might bear fruit, Mr. Filosa noted. Mr. Arora's proposal would complement the workings of the old strategy as well as the new, and might contribute in no small way to the resolution of a few cases under the old approach.

What Mr. Clark had said about the problem of competition for scarce resources was very germane, Mr. Filosa went on. What was needed to counteract that was coordination within the Fund, and the prior commitment of donors. The Interim Committee should make it clear that the support group process would not be a success without adequate funding, and without appropriate coordination between all levels of government.

His authorities broadly supported the rights approach, Mr. Filosa stated. The Fund-monitored program should be constituted with upper credit tranche conditionality, as the Managing Director had proposed. Guidelines would be needed on how to handle cases in which the performance criteria under those programs were not met, as Mr. Grosche had pointed out on the previous day. He had some difficulty with the idea of financing through the General Resources Account the entire amount of outstanding arrears, both repurchases and charges, however. Such a procedure would imply a prolonged use of Fund resources in a substantial part of the General Resources Account, especially if the repurchase period were lengthened to a ten-year maximum. It would also imply extremely high access levels and the assumption by the Fund of the risks associated with the future repayments of accumulated rights disbursements. That being said, he would support use of General Resources Account resources for funding rights only up to the total amount of outstanding overdue repurchases. Charges would be financed by recycling amounts in the Special Contingent Account that would otherwise be available for distribution to the contributors stemming from the settlement of other overdues cases. In that way, the risks would be diversified as well; some risk would be carried by the General Resources Account, but some would also be borne by those countries which agreed to forgo temporarily the repayments that were due them, and which were being used to cover charges of members in arrears, under the burden-sharing arrangements.

He agreed fully with what Mr. Clark had said about financing for the Fund-monitored program, Mr. Filosa commented. Obligations falling due--both charges and repurchases--under the Fund-supported program should be met in full by the country in arrears and the support group. If in exceptional cases that proved to be impossible, the country and the support group should at least pay charges on time, thus safeguarding the Fund's income position.

The payment of charges in local currency should be allowed only in exceptional circumstances, because it came too close to rescheduling and increased the share of risk borne by the Fund, Mr. Filosa pointed out. Mr. de Groote's proposal for collateral was also relevant in that connection, in order to reduce the Fund's risk.

He recalled the elegant arguments put forward in the previous discussion by Mr. Grosche about the reasons why General Resources Account and structural adjustment facility resources should not be disbursed into arrears, Mr. Filosa concluded. He supported Mr. Grosche's arguments. That notwithstanding, if the arrears problem was to be solved, flexibility would be required. One such more flexible approach would be to allow some use of structural adjustment facility resources by a member in arrears after one or two years of successful implementation of a Fund-monitored program, once a track record had been clearly established. Such use would be contingent upon the member's keeping current with its other financial obligations falling due to the Fund in that period, in conjunction with the efforts of the support group.

Mrs. Sirivedhin stated that the rights approach would be very useful for dealing with existing cases of protracted overdue obligations, and a time frame of two to three years would probably be appropriate on average. However, the Fund should not rule out a shorter time frame--perhaps of one year--for a member whose arrears were relatively small in relation to its quota. A repurchase period of four to ten years, as suggested in the Managing Director's statement, seemed reasonable, as was the procedure outlined for Fund-monitored programs. However, she would appreciate some clarification of how the special policy based on relevant balance of payments criteria would be defined. Both General Resources Account and enhanced structural adjustment facility resources, where applicable, should be available to the member once its arrears had been cleared by bridge financing and support groups.

The burden-sharing mechanism proposed for Special Contingent Account-2 appeared to be a step in the direction of promoting more equity, although the amounts involved would still be a matter of concern for contributing debtors which were themselves in great difficulties, Mrs. Sirivedhin continued. She would appreciate an explanation of the relationship of the new mechanism to the present burden-sharing mechanism, such as the condition under which additional contributions under one might, or might not, be matched with less contributions under the other. The proposal to solicit voluntary contributions on the basis of a more equitable burden sharing, along the lines described in the Managing Director's statement, was another welcome step in the right direction. In the spirit of the concerted effort to strengthen the Fund, she would urge all members who fell into the category of noncontributor under the present burden-sharing system to give serious consideration to participating. The amount to be generated might not in itself be very large, but its importance lay in introducing to the Fund the principle that burdens created by shortfalls in Fund revenue which were not the fault of the entire spectrum of debtors or creditors must be borne by all members, based on Fund quotas, in the same way as the privileges which members enjoyed--such as voting rights, drawing rights, or SDR allocations.

Her chair had already expressed a preference for allowing charges falling due during the period of the Fund-monitored program to be paid in members' own currencies, Mrs. Sirivedhin concluded. A Fund policy could be adopted to require repurchases in four to ten years, as with General Resources Account resources under the rights approach. Allowing the payment of charges in local currencies should present no moral hazard problems, as it would only be permitted for members with Fund-monitored programs, and would mean that the member in arrears would be paying interest on those amounts and would itself be responsible for meeting repurchases as they fell due. She believed that that would be the best solution, considering the questions raised by using structural adjustment facility resources of about SDR 600 million for that purpose. In any case, either method would be preferable to permitting the further accumulation of arrears.

Mr. Thorláksson made the following statement:

On the financing of Fund-monitored programs, we can accept the application of the rights approach in a few limited cases. The Managing Director's suggestions on the financing of this approach, however, raise a number of serious concerns and, consequently, I am afraid that we are not in a position to approve them as they stand now. With the danger of sounding agnostic, let me state the most serious ones.

As a matter of principle, we continue to prefer that the rights approach be applied to accumulated repurchases only. We are skeptical about the inclusion of accumulated charges. Furthermore, we believe that the rights approach should be based solely on General Resources Account resources, preferably relying on the usual conditions regarding the repayment period and rate of charge. However, this chair might be willing to consider, on a case-by-case basis, a repayment period similar to that applying to the extended Fund facility--four to ten years--provided that the Fund-monitored program is comparable to a program under that facility. Establishing a special policy might thereby be avoided. Comments on this from the staff would be appreciated. If, however, the Fund-monitored program takes the shape of an ordinary stand-by arrangement, we will have difficulties in extending the repayment period beyond the normal three to five years.

On the procedures for endorsing the Fund-monitored program and the accumulation of rights under the program, I am in basic agreement with the Managing Director's proposal. However, I would like to state a strong preference for an even phasing, not only within the annual programs, but throughout the entire program period. Moreover, in cases of noncompliance with program targets, I believe we should establish a clear deadline--for example, six months--after which time the rights will lapse, in order to avoid an open-ended situation. That would also be in accordance with the usual Fund policies.

On the burden-sharing mechanism, we agree with the need to strengthen the Fund's reserves through an enhanced burden sharing. Accordingly, we are willing to consider a further reduction in the rate of remuneration, as suggested, provided, however, that the rate of charge is adjusted symmetrically. Full symmetry in the adjustments of the rates of remuneration and of charge can be justified, beyond the basic principles, by the mitigation scheme introduced via the Arora mechanism. I agree, however, with other Directors that the result of the Arora proposal, if adopted, might be somewhat disappointing, as most central banks and budgetary authorities will find it difficult to provide the expected resources.

The Fund should stick to its basic principles on the keeping current problem, which means that it should refrain from disbursing into an arrears situation. My authorities maintain the view that, preferably, this problem be dealt with entirely through the support and consultative groups. Accordingly, we are also opposed to the idea of either payment of charges in local currency or a further accumulation of charges throughout the Fund-monitored program. I recognize, however, the difficulties involved in obtaining sufficient resources in all cases, and on a personal basis I believe we should consider the matter of sequential clearing of arrears further, in order to alleviate the financial burden on the support groups. How-ever, any solution involving sequential clearing should be part of a general package or scheme relating to the clearance of arrears to all international organizations.

Despite the Managing Director's convincing arguments, the Nordic countries, and, in particular, the country in my constituency which has contributed to the ESAF Trust, still oppose the idea of using Special Disbursement Account resources in connection with the arrears strategy.

Even though progress has been made in our discussions, I am afraid that we still have some way to go before my authorities will be able to join a compromise on the arrears strategy.

The Chairman commented that since at present most Fund members were not contributing to support groups, the problem of competition for members' resources between support groups and the Arora proposal did not arise. He agreed, however, that the Fund could not count on the inexhaustible goodwill of members making contributions. The Arora proposal, in his view, laid the groundwork for a broadening of assistance for support groups, and provided a foundation and a credible mechanism for voluntary contributions in that regard.

Mr. Finaish made the following statement:

I agree with the Managing Director that not all of the protracted arrears cases should require the exceptional financing mechanisms being proposed. In some of the protracted cases, or perhaps in most of them, as the Managing Director suggests, a solution could be envisaged on the basis of the current approach;

but perhaps this is more a hope than an expectation. However, that will depend, among other things, on the readiness of creditors and donors to assume the responsibilities envisioned for the support groups under the current strategy. I am afraid there is the potential for a moral hazard problem here as well. To the extent that support groups may find it easier to participate in the financing package under the new strategy than to assume all the financing responsibilities assigned to them under the old approach, some cases which otherwise could be resolved under the current approach will end up under the new strategy. I hope this concern will prove to be unfounded, not only because of cost implications for the Fund and for the participants in burden sharing, but also because applying the new strategy to cases which could otherwise be resolved under the current approach is likely to result in delaying the full normalization of relations between those countries and the Fund.

The other moral hazard problem--namely, the special treatment which would be accorded to countries in protracted arrears--is of course on everybody's mind. Although this problem cannot be completely eliminated, I believe the preventive measures which are already in place, and those being suggested, should minimize the risk of moral hazard. Mr. Evans's suggestion to make the special facility under which exceptional financing will be provided to countries in protracted arrears a once-and-for-all facility, with a specified termination date, would also help reduce the risk of moral hazard. Perhaps this was implicit in the Managing Director's statement, but in that case, it would be useful to make it explicit.

Regarding the financing of the stock of overdue obligations, we have already expressed our support for the rights approach which would allow, and also justify, such large disbursements as would be needed to clear the arrears frozen at their premonitored program level. In previous discussions, we have, however, also emphasized that the terms of the new lending should be compatible with the balance of payments position and debt-servicing capacities of the relevant countries. The Managing Director has proposed repurchase maturities of four to ten years, but has argued against a concessional rate of charge on the ground of moral hazard. I would not dismiss that argument, and perhaps, as I suggested yesterday, the Board will find it possible to review the compatibility of the terms of Fund lending with the needs of members in a more general way in the future. But, coming back to the question at hand, we continue to believe that extending such large amounts of General Resources Account resources at 9 percent or 10 percent rates of interest is not the best way to go. In fact, we have much sympathy with the remarks made by Mr. Enoch yesterday on this issue. Most of the protracted arrears countries are eligible for the enhanced structural adjustment facility, and it would make a lot of sense in our view to use enhanced structural adjustment resources under the rights approach in the relevant cases.

We are, of course, sensitive to the concern of some contributors to the enhanced structural adjustment facility about the appearance of a shift in the risk from the General Resources Account to the ESAF Trust. But one has to keep in mind that the countries in question are eligible for the enhanced structural adjustment facility. What is more important, under the rights approach disbursement of enhanced structural adjustment resources will occur after two or three years of good performance under a program of the enhanced structural adjustment facility type. This in itself should make the risk of enhanced structural adjustment resources disbursed to these countries at least as low, and probably lower, than the risk associated with normal disbursement of such resources to other countries. Of course, smaller amounts of General Resources Account resources could be combined with the accumulation of rights under the enhanced structural adjustment facility.

We have some difficulty understanding the rationale for the suggestion to back the resources disbursed under the rights approach through an expanded burden sharing, as proposed by the Managing Director. If the resources are disbursed to the member after three years of good performance under a strong monitored program, then the value of the Fund's claims on that member will be much higher than it is now. I believe Mr. Grosche himself made a similar point yesterday. The "backing" proposal seems to imply the opposite.

We have noted with interest the different suggestions that have been made regarding possible gold transactions either to assist in the financing package directly, or to enhance the security of the claims of enhanced structural adjustment facility contributions.

On the Managing Director's proposal regarding Mr. Arora's suggestion, I have some sympathy with the remarks of Mr. Landau on this issue in yesterday's discussion.

I would like to endorse the Managing Director's view that the primary responsibility for financing the Fund-monitored program under the rights approach, including obligations coming due to the Fund, should remain with the support group and the member itself. I would like to reiterate what I said in previous discussions on the need for a special effort by support groups to establish

> specific mechanisms to ensure that the required financing will indeed be available. Otherwise, the risk of disruptions to the adjustment program will persist. This is a risk which is always costly, but in this case would be much more so.
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> I would also agree with the Managing Director that in some cases it may be unavoidable for the Fund to participate in financing some of the obligations coming due, and more specifically current charges, during the period of the monitored program. Although we remain open to the possibility of allowing members, in appropriate circumstances, to pay charges in their own currency as provided for under Article V, Section 8(e), we would agree with the Managing Director that this may not be the best course if an alternative can be found. The proposal to use Special Disbursement Account resources not yet committed under the structural adjustment facility may well be such an alternative, and we would be willing to support it. Since Special Disbursement Account resources can be traced back to the gold sales of the 1970s, one fringe benefit of this proposal is that, after all is said and done, the final package will have some of the glitter which some had wanted to see in the new strategy.

The Chairman remarked that he wondered whether the differentiation that had been made between use of enhanced structural adjustment facility resources and General Resources Account resources in relation to a rights accumulation program was not somewhat artificial. In fact, those two sources would probably be used almost simultaneously. The General Resources Account resources would be used to clear the way for the subsequent Fund program under the enhanced structural adjustment facility of two to three years' duration once the arrears had been cleared; of course, the enhanced structural adjustment facility resources would be phased.

Mr. Finaish said that the attraction of enhanced structural adjustment facility resources was their concessionality. Burden sharing would be reduced in that connection as well, which had been a concern of a number of Directors. The remaining issue, as Mr. Grosche had put it on the previous day, was one of risk, but he believed that was beginning to be addressed to Mr. Grosche's satisfaction.

The Chairman added that use of enhanced structural adjustment facility resources after the clearance of arrears by members eligible for that facility would be fully in keeping with the facility's original purposes.

Mr. Grosche said that he could go along with that approach. He was in favor of refinancing overdue repurchases with General Resources Account resources. He recognized the concerns of Mr. Enoch, Mr. Filosa, and Mr. Finaish about the potential burden on the country of servicing the amounts that would come forward from the encashment of rights accumulated during a Fund-monitored program if overdue charges, as well as repurchases, were included in the refinancing. The Board would need to address the problem of how to make the burden of repaying both charges and repurchases supportable for a member which had recently emerged from arrears; perhaps an extension of the repayment period might be considered.

The Chairman remarked that a number of speakers had seen the possibility of granting extended Fund facility-like repayment terms to such obligations, and others the usefulness of applying structural adjustment facility-like concessionality to them. The application of Mr. Arora's proposal to the support group process would also serve to increase the concessionality of resources extended to members newly emerged from a situation of arrears.

Mr. Feldman stated that he supported the rights approach, which was a realistic solution, particularly for the larger and more protracted arrears cases. The Director of the Exchange and Trade Relations Department had stressed that the financing exercise would be limited to the 11 existing arrears cases. For the reasons given in the Managing Director's statement, he believed that the rights approach would apply only to a small number of cases in which a large stock of arrears was outstanding.

He regretted that no further thoughts had been given to Mr. Posthumus's proposal to convert an amount of arrears corresponding to accumulated rights periodically into a tranche of a stand-by arrangement, Mr. Feldman went on. That was an attractive proposal, allowing the stock of arrears effectively to decline during the period of implementation of a Fund-monitored program. It also had advantages in terms of the phasing out of payments and repurchases to the Fund. He supported the idea of adopting a longer repurchase period, at least as long as that under the extended Fund facility.

On the backing for the rights approach, he mostly shared what Mr. Finaish had said, Mr. Feldman remarked, especially in relation to the increase in value of the Fund's claim following the period of the Fund-monitored program, and taking into account the fact that the Fund's exposure to those countries would not increase. In any case, if the proposal for providing backing gained adherents, his first preference would be for a quota-based burden-sharing system, but he could go along with an extension of the burden-sharing mechanism along the lines proposed by Mr. Dawson, with equal amounts generated by a lowering of the floor to the remuneration coefficient to 80 percent of the SDR interest rate and a symmetrical increase in the rate of charge. That would imply a very high rate of charge for debtor countries, however, and difficulties with repayments to the Fund. He shared Mr. Kafka's concerns in that respect.

Drawing upon Mr. Arora's proposal, the Managing Director's statement suggested a new mechanism of voluntary contributions based on quota shares by those members either not contributing under the current burden-sharing system, or the contributions of which were smaller than the average for all members, Mr. Feldman recalled. He could support that idea, although, like other speakers, he had some doubts about its success given its voluntary character.

He supported the mobilization of structural adjustment facility resources for financing Fund-monitored programs in the cases of structural adjustment facility-eligible countries, Mr. Feldman concluded. The Managing Director's statement presented very good reasons for that, in his view. He would like to stress the need for tailor-made solutions for the three countries in arrears that were not structural adjustment facility eligible. He could support the payment of charges in local currency, although it had the disadvantage of continuing the financing of deferred charges under the burden-sharing system, creating an additional cost for debtors and creditors.

The Chairman commented that Directors may have been a bit hasty in attaching the term rescheduling to Mr. Posthumus's proposal. He would not wish to discourage Directors from exploring use of that approach under certain circumstances. It would add perhaps another weapon to the Fund's arsenal for dealing with the arrears problem.

Mr. Posthumus said that he had put forward his idea as a very tentative exploration of a way between rescheduling and not rescheduling, nothing more. Although the Articles of Agreement permitted rescheduling under certain circumstances, he was aware that certain Directors were opposed to it, and he was trying to find middle ground between the two.

Mrs. Filardo stated that the main failure of the present strategy was the lack of financing, given the unwillingness of creditors and donors to participate in the financing of a program for a country in arrears. The Fund needed to recognize that, as a cooperative and financial institution, it would have to solve its own problems.

Another main issue related to the moral hazard problem was the unwillingness to recognize that, in many cases, debt relief or debt forgiveness was needed, Mrs. Filardo noted.

She fully agreed with the Managing Director's proposal on the rights approach, and with some of the observations of Mr. Kafka, Mrs. Filardo continued. Nevertheless, she agreed with Mr. Filosa about the need to provide resources to solve the arrears problem. Every solution that had been suggested would seem to present problems for those who believed that they were already contributing through different sources--the reduction in the rate of remuneration, the increase in the rate of charge, or contributions to the enhanced structural adjustment facility. Everyone believed that the international community should share the burden equiproportionally, but the concept of "international community" had become difficult to define, when the general point of view appeared to be that that concept concerned only everyone else. That reality needed to be faced. A problem remained to be solved, and a clear strategy, in which every participant made a contribution in a very strict sense, needed to be formed for that purpose. As Mr. Filosa had indicated, an idea, ex ante, of the scale of resources that would be committed was necessary. When the idea of a compulsory set-aside of a portion of the quota increase to help share the burden of the arrears problem had been put forth, it had had several connotations. Quotas should be the standard measure of the institution as a matter of principle. The Fund, as a proxy for the international community, needed to solve the fundamental financial problem that faced the community on the basis of quotas.

The Managing Director had suggested that financing be obtained from various sources--the country itself, the support group, and a reinforcement of the present burden-sharing mechanism, Mrs. Filardo recalled. She had doubts about the effectiveness of the support group and whether it would be successful in obtaining the financing required. She also had concerns about whether or not a country which found itself in a crisis would be able to make a substantial contribution. The country should be requested to make a great effort, but some thought should be given to exactly how that would be done under the circumstances.

Along with her Mexican authorities, she would prefer to freeze the present burden-sharing mechanisms, Mrs. Filardo stated. She would indeed be concerned were she to have to approach the Mexican authorities and relate to them that they would have the privilege of sharing the burden of arrears on the same level as the Federal Republic of Germany and the United States.

If an amendment of the Articles of Agreement was to take place, she did not see any problem in enforcing the Arora proposal, Mrs. Filardo continued. If the proposal was put to the legislatures in a constructive way, it would be approved easily, and would be seen as a fairer system than one based on the current burden-sharing principles. The second-best solution might be Mr. Dawson's proposal on the mobilization of gold, with some modifications to ensure that a reasonable amount of resources would be forthcoming. In that respect, the Fund would be using an asset owned by the membership, including the countries in arrears, without introducing distortions into either the structural adjustment or enhanced structural adjustment facilities.

Her Spanish authorities agreed with Mr. Grosche with respect to the inherent inappropriateness of the present burden-sharing mechanism, which served to irritate both creditors and debtors to the Fund, Mrs. Filardo concluded.

Mr. Posthumus commented that a large part of the business of the support groups was the aid business, and in that respect, it needed to be acknowledged that the support groups followed the ground rules of the aid business. That implied that some donors concentrated their activities on certain countries, and other donors on others. A burden-sharing mechanism already operated in that regard, which needed to be taken into account. It would be important not to try to mix together too much the business of the Fund in trying to solve arrears, and the business of the support groups, accordingly.

He found the Managing Director's proposals on the financing for the rights approach on the whole acceptable, Mr. Posthumus went on. He did not object in principle to the proposal to depart from symmetrical burden sharing for the contributions to Special Contingent Account-2. Such symmetrical burden sharing, while perhaps appearing to be fair, was actually only an arbitrary determination. Considering the great disadvantages which a very high rate of charge would bring to bear on the Fund's accessibility to all its members, his authorities might be prepared to go even farther in the direction of placing a greater burden on Fund creditors than the Managing Director had proposed in that regard.

He continued to have doubts about accepting, without further analysis, the idea that quotas represented an appropriate basis for the distribution of certain financial burdens, Mr. Posthumus stated. At first glance, that idea might appear to be fair, but quotas had not been formulated with a view to their deployment in a burden-sharing mechanism. For example, variability of a country's receipts was an element in deciding the size of its quota, and he could not see how variability could be used to determine the ability to pay certain costs of the institution. It might be asked why quotas had never been used before in the way that was being suggested at present, and why the Fund's founders had not adopted such a superficially simple and attractive idea. He believed that the fact that the present system of financing the Fund did not function very well lay at the heart of the problem, and that it might therefore be necessary to analyze the Fund's financial structure. Such an analysis could not be done in a few days or weeks.

The Fund was financed, at least notionally, with shares, Mr. Posthumus pointed out, but in fact, the Fund was financed with bonds, because the Fund guaranteed its creditors a certain rate of remuneration. In that sense, all of the institution's costs--the usual costs of charges and special costs of overdue charges and repurchases--would have to be borne by borrowers from the Fund. If the special costs rose, it was a commonplace that they always did so at the wrong moment, when charges were already high and were rising, because at the same moment the Fund was lending more and more to highly indebted countries, thus putting itself more and more at risk. Risk was the Fund's business; but the Fund needed to ensure that it had the financial structure to bear that risk, and it was there that his questions lay. The financial structure of the Fund needed to be looked at apart from the issue of the quota increase--rather, as part of the discussion on the Fund's financial position, in his view.

Those issues needed to be explored before new ways were devised to finance the Fund or certain parts of the Fund, Mr. Posthumus concluded. Apart from those observations, he could go along with the Managing Director's proposals.

Mr. Filosa observed that coordination in providing resources through support groups was both feasible and necessary, notwithstanding the particular interests of donor countries, as Mr. Posthumus had pointed out. Such coordination had been evident in the support groups for Guyana and Somalia, for example. The Arora proposal would provide a basis for the overall determination of appropriate contribution levels, which might then be parceled out in accordance with the interests of particular donors. Coordination would remain key, in his view.

Mr. Clark commented that through the support groups the Fund was, de facto, involving itself in the aid business, and was thus confronted with the problem of competing resources. In making budgetary allocations on a national level, substitutions were often made in order to cut back on overall spending. A broader-based support group mechanism to replace the current system might provide a new formula for burden sharing, and give greater certainty both with respect to the total amount of resources that would be available to support groups and the timing of the disbursement of those resources. The question of whether the new mechanism would replace or complement the present one also raised the issue of competition between resources for the Fund and for aid agencies; if it were meant as complementary, competition would continue.

The Chairman remarked that the possibility of competition for resources between the Fund and national aid agencies in respect of support groups could not be ignored. It had been part of a larger problem for those donors leading support groups, but it needed to be recognized that the Fund and aid agencies were nevertheless serving the same purpose. Often, the Fund was involved in creating the conditions for the rescue of the aid programs of national aid agencies, and the Fund's actions should therefore be viewed as supporting the aid agencies' efforts. He realized that much remained to be done to convince the aid agencies of that point, however.

Mr. Kabbaj stated that he wished to confirm his approval of the rights approach, with the understanding that it would be limited to a small number of countries with large protracted arrears so that the moral hazard mentioned by Mr. Finaish was avoided.

With respect to backing for the rights approach, his authorities were concerned that burden sharing could become the main instrument for dealing with the arrears problem, Mr. Kabbaj went on. They felt strongly that it would be unfair to put the burden of the problem on the members--creditors and debtors alike--which discharged faithfully their obligations to the Fund. They wished to point out that the effects of the proposed burden-sharing scheme on the rate of charge--which would rise to close to

11 percent--would have grave implications not only for debtor members which strove to discharge their financial obligations to the Fund despite their own difficult problems, but also for the Fund and its credibility as a catalyst for the rest of the international financial community. He wondered what would be the reaction of commercial banks when the Fund asked them to reduce the debt burden on some members. His authorities also pointed out that the concessionality of the Fund's ordinary resources, which had been one of the main features of the Fund in encouraging member countries to come to the Fund at an early stage of their difficulties, had disappeared.

Those facts led him to plead for a more generous position on the part of his colleagues in the industrial countries, Mr. Kabbaj continued. He recognized that alternatives would not be easy to find, but he would prefer burden sharing distributed according to quotas. If that was not feasible, his authorities would accept as a maximum Mr. Dawson's proposal as amended by the Managing Director. His authorities opposed the features attached to the proposed Special Contingent Account-2, and, like Mr. Kafka, would prefer continuing with the present special contingent account system. He agreed with the possibility of using structural adjustment and enhanced structural adjustment facility resources in financing the rights approach, and with the Managing Director's proposal to allow the payment of charges in local currency.

He wondered what would happen to the package if the support groups failed to deliver what was expected from them, Mr. Kabbaj concluded. Perhaps the staff could comment on that. In particular, he wondered what the consequences might be for burden sharing or for other parts of the package. Since many of his colleagues had expressed doubts as to the effectiveness of support groups and the likelihood of securing adequate financing in that way, he wondered what the implications might be for the members in arrears, as well as for the entire Fund membership. Would other members fill the gap?

The Chairman said that, although both the Arora proposal and the support group process were voluntary in character, he believed that they held much promise. Even though in certain cases the critical mass had not yet been reached--in the case of Guyana, for example--significant contributions had nonetheless been forthcoming. If some type of structure or instrument were to be imposed on the support group process--which was essentially voluntary--support groups would simply disappear, and a valuable contribution to the Fund's arrears strategy would be lost.

Mr. Kabbaj remarked that his fear was that if the support group process failed or if it failed to come up with adequate resources, enlarged burden sharing would be activated to make up the difference.

The Chairman commented that one of the rules of the support group game was that it was never certain whether adequate financing would be forthcoming. Only a reasonable presumption of that financing could be achieved, with contingencies to modify the program here or there if enough financing ultimately failed to materialize.

The Director of the Exchange and Trade Relations Department said that support groups were generally only set up once a financing requirement from certain donors had been determined to exist. The issue was what would happen if only, say, 20 percent of the expected financing were missing. In that case, either resources would have to be found from elsewhere, or a greater degree of adjustment would be required of the country concerned, in the form of import compression. The idea that a country's adjustment efforts should fall off if the expected financing were not forthcoming could not really be true in practice, since it would not be in the interests of the debtor or the debtor's people; adjustment should be as strong, if not a good deal stronger.

The Chairman remarked that a country entering into a Fund-monitored program needed to be convinced beforehand that, regardless of the contributions of others, the adjustment policies were for the good of the economy and its people, to be implemented as soon as possible. Such adjustment might be made more efficient with outside support, but that support should not be seen as essential.

Mr. Finaish commented that one of the major problems of support groups appeared to be the question of the distribution of the burden of contributions among the donors and creditors. Proposing a mechanism that would help the support groups in making that determination would be useful.

Mr. Nimatallah said that there would be merit in the Fund's proposing some notional criteria for support group contributions, as Mr. Finaish had noted. Those criteria would assure greater equity in the support group, and would also give general guidance as to the aggregate amount of resources that might be forthcoming. The Fund could even suggest the creation of an escrow account into which funds would be placed by a certain deadline, and in that respect, greater certainty as to timing of disbursements might result. Those innovations would not detract from the essentially voluntary character of support groups, but would make the process more certain and more efficient, in his view.

Mr. Evans said that the Managing Director's statement had drawn together the strands of the Board's discussions very well, and he would comment only on those areas that gave him some problems, hence implicitly supporting the others. He wished to endorse Mr. Clark's comments on the importance of adequate financing of programs, and what that implied for the Fund's own contributions. In that vein, he would support looking further into Mr. Posthumus's variation on the rights proposal, and for the same reasons as mentioned by Mr. Clark.

He could not support a voluntary levy along the lines suggested in any terms, Mr. Evans commented. Mr. Enoch had addressed that issue very well the previous day, and had spelled out the arguments well. Such a levy would become an embarrassment to the Fund, not least because it would not receive the resounding endorsement that it would need at the outset to make it workable.

The rights approach had been spelled out quite well in the Managing Director's statement, Mr. Evans continued. He would like to raise again, as Mr. Finaish did, the point he had made earlier that such a facility should have a fixed life to reduce the moral hazard problem.

He would like to see the Board review the burden-sharing issue properly, as suggested by Mr. Posthumus, Mr. Evans went on. Until that was done, however, he believed that if there was to be enhanced burden sharing, it should be applied in a symmetrical manner between debtors and creditors, at least until it was assured that all aspects of the enhanced strategy were working as they were intended to.

The Board's discussions had taken it a long way in heightening awareness of the arrears problem, Mr. Evans concluded, in part related to an awareness of how fairly--or unfairly--the burden of arrears was being shared. He believed that certain elements of the arrears strategy--compulsory withdrawal, for example--would not be utilized unless an awareness of that unfairness were maintained. In that sense, the system of an unfair tax which the burden-sharing mechanisms represented needed to be preserved in order to make the arrears strategy work completely.

Mr. El Kogali said that he welcomed the Managing Director's statement on financing of Fund-monitored programs. It showed the rewards that members which cooperated with the Fund might receive, and was a departure from the punishments which the Board had been discussing heretofore in connection with arrears. He saw all of the innovative ideas that had been put forth in a positive light.

The Executive Directors agreed to continue their discussion in the afternoon.

DECISION TAKEN SINCE PREVIOUS BOARD MEETING

The following decision was adopted by the Executive Board without meeting in the period between EBM/90/21 (2/20/90) and EBM/90/22 (2/21/90).

2. APPROVAL OF MINUTES

The minutes of Executive Board Meeting 89/89 are approved.

APPROVED: November 28, 1990

LEO VAN HOUTVEN
Secretary