0404

INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 90/23

3:00 p.m., February 21, 1990

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

| Executive Directors | Alternate Executives 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 | |
| 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

African Department: 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, 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: P. Isard. 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, A. Gronn, Z. Iqbal, J. M. Jones, K.-H. Kleine, 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, L. Hubloue, C. Y. Legg, J. A. K. Munthali, D. Saha, J.-P. Schoder, J. C. Westerweel, Yang J.

1. OVERDUE FINANCIAL OBLIGATIONS - STRENGTHENED COOPERATIVE STRATEGY

The Executive Directors resumed from the previous meeting (EBM/90/22, 2/21/90) their consideration of the Managing Director's statement on overdue financial obligations to the Fund, continuing their discussion of the section dealing with financing of the Fund-monitored program.

Mr. Dai stated that he supported the rights approach in general, and could be flexible with regard to the detailed mechanisms. He could go along with the idea of using both General Resources Account and enhanced structural adjustment facility resources under the rights approach. He also agreed that uncommitted resources in the structural adjustment facility might be used in certain cases during the period of the Fund-monitored program. Of course, that step should be confined to highly exceptional situations.

However, he shared the concerns on the increased burden that would be created by the extension of the burden-sharing mechanism, Mr. Dai continued. He wondered whether some alternative could be explored to meet the backing requirement for the rights approach, or whether the backing mechanism could be reconsidered if there were assurances to safeguard Fund resources through a strengthening of the arrears strategy and the work of the Fund in program design and monitoring. Moreover, among the 11 countries in arrears, only a few fell into the category to which the new approach might be applied. The figures shown in the Managing Director's statement may have overestimated the magnitude of the financing implications. If the financing required was in fact less than it looked at present, perhaps some different and fresh thoughts might be forthcoming on how to find a solution to the problem.

Support and consultative groups should play the key role in the process of clearing arrears, and the role of the Fund in assisting the efforts of the support groups should be strengthened, Mr. Dai concluded. On the mobilization of financing for the support groups, the political will of major creditor countries, as well as economic rationality, would be of key importance. If there were strong political will to cooperate and solve the problem, the financing would be there. He wondered whether the Chairman, in his competence and wisdom, could again mobilize wide support from the creditor countries in that regard, for an amount that would be much less than the amount for the enhanced structural adjustment facility which he had initiated in 1987.

The Chairman said that he was moved by the confidence Mr. Dai had placed in him. However, he was afraid that he was not up to meeting such expectations. He would nevertheless strive to encourage members to become involved in the support group process, and to manifest a degree of flexibility in adopting mechanisms to address the arrears problem.

Mr. Arora commented that the section of the Managing Director's statement on the financing of Fund-monitored programs was comprehensive, had been

drafted with great skill, and reflected the Managing Director's great understanding of the different points of view that the discussions had revealed, as Mr. Kafka had also noted. The proposal would serve well to reintegrate members currently in arrears into the international financial community.

The rights approach offered an imaginative and bold solution to the question of how to tackle the problem of existing arrears, Mr. Arora continued. He was certain that all Directors would agree with that assessment. The proposal sought simultaneously to strengthen the Fund's financial position through an extension of the burden-sharing mechanism as described by Mr. Dawson. The international financial community, as represented in the Fund, had a responsibility to keep the Fund's financial position strong. The only question that needed to be answered in that regard was how that should be accomplished, bearing in mind the consequences for different sections of the Fund's membership.

The present system that had been established to safeguard the Fund's financial position--the burden-sharing mechanisms--while not unfair in abstract principle, operated unfairly in practice against the debtor countries, Mr. Arora pointed out. He understood the argument that without those mechanisms, the entire burden of overdue charges would be borne by the debtors. Nevertheless, the existing economic, social, and political realities needed to be taken into account, and for that reason, the burden-sharing system should be looked at again, to see whether it could not be improved upon. Although a legal, constitutional way out of the problem might be very difficult, if the Fund membership could be persuaded to take a larger view of its responsibilities, another way out, not involving those considerations, might yet be found. He was grateful for the remarks of Mr. Filosa and Mr. Landau about quota-based burden sharing. In that connection, while he appreciated the arguments of those of his colleagues who had not been in favor of such an approach on the grounds of its lack of feasibility, he remained convinced that the application of the spirit of voluntarism might result in some supplemental resources which could serve to ameliorate the larger problem. While he supported the concept of burden sharing, therefore, he had reservations about the exact method that was being proposed.

He had no difficulties with the other proposals that had been set out about the rights approach, Mr. Arora noted.

Once a country's arrears were frozen and the rights approach had been adopted, the key issue became how to keep members current during the period of the Fund-monitored program, Mr. Arora observed. The Board needed to think about how a process of deaccumulation of arrears could then be begun. The Managing Director's proposal was that it would be the responsibility of the support group and the member itself to meet charges and repurchases falling due during the period of the Fund-monitored program. He feared, however, that the support groups would be expected to bear too much of the

burden, and if the efforts of support groups then failed, the entire arrears strategy would become unstuck. Perhaps another way could be found to support a member following a Fund-monitored program. He was aware of the concerns of some Directors about disbursing into a situation of arrears, but perhaps the undisbursed amounts remaining in the Special Disbursement Account of the structural adjustment facility could be employed during the period of the Fund-monitored program to meet obligations falling due, thus relieving some of the burden on the support group.

An alternative, which he believed had been discarded, would be to allow the payment of charges in local currency, Mr. Arora went on. Perhaps the Fund could see its way to extending such a kindness, in light of the strong program that the member was undertaking. The process of deaccumulation of arrears would thus be begun. He recognized that that was a bookkeeping device and not a real solution to the problem, but it had many advantages nevertheless; the chief one would be that the country in arrears would at last see the light at the end of the tunnel, while not affecting at all the Fund's financial position, since burden sharing would still be in force. Another alternative might be to employ amounts raised as collateral not to strengthen the Fund, but to be applied to cases of arrears. Yet another might be to use amounts raised through burden sharing to disburse into arrears and help the countries following Fund-monitored programs to keep current. Because all of those alternatives would apply only to a small group of carefully circumscribed countries, the problem of perpetuating them would not arise; it would be clearly known that they would be applied only to a very small number of cases.

If some other ideas for supporting members during the period of the Fund-monitored program were not forthcoming, he foresaw a future in which arrears would continue to mount, Mr. Arora remarked, especially when recent experience with support groups was taken into account. The possibility of compulsory withdrawal for some members could not be ruled out in such a future, with unfortunate ramifications for the Fund as an international institution.

He appreciated the concerns that had been expressed that, by pursuing such alternatives, some of the Fund's basic principles would be jeopardized, Mr. Arora remarked. In the final analysis, however, the question that needed to be raised was the cost that the Fund would have to bear in order to preserve its principles. The cost, in his view, would be in terms of mounting arrears, an increased rate of charge, compulsory withdrawal, and a general sense of disorder. History showed the evidence of sticking to principles regardless of other considerations. The choice was between sticking to principles and plunging the Fund into a maelstrom of dysfunction, or perhaps departing a bit from those principles and being flexible, by imposing costs both on the member in arrears and the Fund. If that were accepted, the key to the problem might be found.

With respect to burden sharing, an expanded burden sharing would lead to a rising rate of charge, with ramifications not only for borrowing members, but for the character of the Fund as well, Mr. Arora concluded. Those ramifications should be weighed carefully before proceeding in that direction, in his view.

Mr. Mawakani stated that the Managing Director's statement was a good basis for discussion. On the question of financing the Fund-monitored program, all possibilities of assisting countries in arrears had been explored, and he had no major difficulties with the proposals put forward. His final view on the different issues addressed would be expressed once he knew the content of the entire package of the Ninth Quota Review.

He joined other speakers in supporting the implementation of the rights approach along the lines suggested in the statement, Mr. Mawakani continued. General Resources Account resources should be used to finance the rights accumulated by countries in arrears. The duration of the repayment period should be extended to four to ten years.

He supported the Managing Director's statement concerning the Fund-monitored program, Mr. Mawakani noted, particularly the suggestion to use structural adjustment facility resources and the temporary use of local currency to pay charges, which could be a temporary relief for some countries in arrears.

He was among those who believed strongly that the present burden-sharing mechanism was not equitable, and that efforts should be made to base it on quotas, Mr. Mawakani stated, especially given that the Fund was a quota-based institution. However, in view of the work that remained to be done on the issue of the whole quota package, he was prepared to support the proposal made by Mr. Dawson, as amended by the Managing Director--which would reduce the burden on debtor countries to half that borne by the creditors.

He considered Mr. Arora's proposal to be a reflection of a relevant principle in dealing with the issue of burden sharing while helping countries in arrears to rehabilitate their economies, Mr. Mawakani concluded. In that connection, he shared completely the arguments of Mr. Filosa and others. The Arora proposal would be a workable one if the Board presented it to members in an attractive way.

Mr. de Groote considered that the Managing Director's statement on the financing of the Fund-monitored program was a broad outline for further work, and indeed, for further agreement. In fact, he hoped that the agreements that had been reached already could be consolidated, and not reopened for renegotiation. In particular, he noted that while the modalities for the rights approach might remain to be determined, the basic principle itself had received broad-based support. That in itself should be seen as an important achievement.

There were a number of areas in which further work would be needed, Mr. de Groote observed. One was the establishment of an appropriate mechanism to reinforce the support groups during the implementation of the Fund-monitored program. The Board had considered a number of proposals in that connection, among them that of Mr. Arora. In its discussions the Board had returned again and again to the issue raised by Mr. Kafka and Mr. Nimatallah, namely, the need to provide a country with enough resources to start implementing a Fund-monitored program, while protecting the Fund. He was not sure that any clear view had yet been reached on that issue.

A second issue was how to keep a country current in its financial obligations to the Fund during the period of the Fund-monitored program itself, Mr. de Groote continued. He had proposed allowing the temporary payment of charges in local currency as one solution, and others had put forward the idea of allowing structural adjustment facility resources to be used in that connection. He was quite open-minded about the latter, and had noted the convincing arguments that had been made by Mr. Landau, Mr. Arora, and others. He had presented the idea of allowing the payment of charges in local currency not so much in relation to the need to repay charges on time, but to ensure that a country reserved enough domestic currency in its budget to enable it, in time, to exchange the local currency for foreign currency to make repurchases. A stumbling block in the implementation of programs was often not so much the foreign exchange component, but the appropriate mobilization of domestic currency resources. If that reasoning were accepted, the conclusion was that domestic currency resources should be used to reimburse the Fund--which did not exempt a country from converting domestic currency into reserve currencies later. To be realistic, the conversion should be progressive. In the long run, the burden for countries in arrears would be alleviated.

Another area which probably required further work was the contribution of all members to the solution of arrears, Mr. de Groote commented. More work on a mechanism that would bring countries' contributions more in line with their relative quota positions was needed. The extension of the burden-sharing mechanism the Managing Director had proposed, together with some of Mr. Dawson's ideas, went some way in achieving that purpose in the aggregate, and would impose a larger burden on creditor countries, which could be understood since those countries had the largest quota shares. A way to approach the issue of those countries which currently did not contribute at all under the burden-sharing mechanisms might be to encourage them to take that fact into account in assessing their involvement in support groups. The real scope of the Arora proposal, a subject already commented on by Mr. Filosa, who had introduced a number of important distinctions, also needed to be reflected upon.

All that being said, it might be premature to expect the Board to consider a total package in the following few days, Mr. de Groote concluded. In that respect, he agreed with the comments made by the Nordic chair. He believed that the issues he had drawn attention to required further work,

and perhaps more elaboration in another document from the staff, so that the Board's choices could be refined further. In that connection, perhaps the Board could advise the Ministers in the Interim Committee of its discussions. If the Ministers decided that the deadline of March 31, for considering the Ninth General Review of Quotas should be extended, the Board's work on the issues remaining unresolved might be made easier, and a more solid consensus achieved.

The Chairman observed that Mr. de Groote had pointed to the need to develop a more solid consensus on a number of the remaining issues, and that the details of some of the modalities of the arrears strategy he was proposing should be better fleshed out. Nevertheless, he saw the deadline of March 31 for completing consideration of an increase in quotas under the Ninth General Review as a firm one. He would therefore propose another extension of that deadline only with extreme reluctance. If he was obliged to suggest such an extension, it would be in the context of a legal structure for concluding the discussion on the arrears strategy as well. It was time to abandon discussion of the general issues involved, and turn to the cases at hand. He would hope that by the end of 1990 he would be able to place some of the largest cases of arrears--Peru and Zambia--under Fund-monitored programs.

Mr. Enoch commented that the views of some of those who had been closely involved with support groups seemed to be different from those of others. He shared the views of Mr. Filosa and Mr. Clark in that regard, with their experience of the Somali and Guyanese cases, respectively. He agreed with Mr. Filosa and others who had linked the Arora proposal to the support group process, as a means of providing additional financing. Those who had been closely involved in the support group process were aware of the difficulties of mobilizing additional resources. While he had doubts about the significance of the contributions that might be forthcoming from a voluntary approach, he nevertheless agreed that if it were presented to members in an attractive fashion, it might be useful, and might indeed achieve some additionality of resources for support groups.

He was surprised that the World Bank and the consultative groups had apparently been overlooked in the discussion as a source of financing, which he believed might prove to be quite useful, Mr. Enoch continued. In that connection, there was a danger that, in having discussions almost simultaneously in the World Bank on the subject, the Bank might go its own way. It would be important for the Fund and the Bank to be consistent in what they were doing to address the arrears problem.

There was a significant difference in having enhanced structural adjustment facility resources used as part of the rights approach and having them used afterward, Mr. Enoch pointed out. A country which had first a Fund-monitored program financed by the General Resources Account with very large access, followed by a program with smaller access under the enhanced structural adjustment facility, would pay significantly higher charges than

if the sources of financing for the respective programs were reversed--namely, first from the enhanced structural adjustment facility, and afterward from the General Resources Account resources. He believed that there was a significant difference in using concessional, versus nonconcessional, resources in that regard. Perhaps some compromise could be reached.

He was not at all convinced about the advisability of using structural adjustment facility resources during a Fund-monitored program, because of the disbursement into an arrears situation which it implied, but perhaps some role could be envisioned for such resources following the rights accumulation program, perhaps incorporating such resources in a way that would promote the mobilization of nonconcessional resources, Mr. Enoch concluded. It was clear from what the Director of the Exchange and Trade Relations Department had said that a substantial amount of structural adjustment facility resources remained unutilized at a time when the Board was casting about for resources to address the arrears problem. In that respect, the chance to use those resources in some way should not be thrown away, in his view.

Mr. Dawson made the following statement:

> I would like to comment on some of the questions that have been raised regarding U.S. proposals to mobilize a limited amount of gold as part of a strengthened arrears strategy.
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> Our objective is to ensure that the country in arrears bears a part of the costs arising from its failure to fulfill its financial obligations to the Fund. We recognized, however, that a member in arrears would have difficulty in paying penalty or special charges from existing funds, and that, as a result, arrears would occur on these charges and the problems of normalizing relations with the Fund would increase. Therefore, we looked for a method that would provide a contribution from assets or future resources rather than current income.
>
> The proposal to mobilize an amount of Fund gold based on the gold subscription of the arrears country reflected several considerations. First, while recognizing that the gold is owned by the Fund, the arrears country has some residual rights based on its gold subscription. Moreover, as the General Counsel pointed out, a compulsory withdrawal would produce a profit for the Fund since the gold subscription would be retained and any value in excess of SDR 35 per ounce would accrue to the Fund. In effect, mobilization of the member's gold subscription would enable the Fund to realize and utilize this gain prior to compulsory withdrawal.
>
> The amount of gold mobilized would be quite limited--2-3 million ounces, or less than 3 percent of the Fund's gold holdings. Nevertheless, mobilization of such an amount could

generate substantial resources for use in dealing with arrears, possibly as much as SDR 1.3 billion over three years in principal and income at current interest rates and market prices. This compares with the SDR 863 million in present burden sharing, the almost SDR 1.4 billion from an extension of burden sharing under the Managing Director's proposal, and SDR 600 million in structural adjustment facility resources. As such, it would reduce the need to rely on other approaches, which involved increased costs for members fulfilling their obligations.

The Articles of Agreement provide explicitly that the Fund's gold holdings are available for use to meet Fund purposes. Indeed, the Articles make it easier to sell gold than to buy it, in recognition of the fact that the monetary role of gold is declining, and should continue to decline, although gold would remain a valuable asset. The 1975 Jamaica decision to sell 50 million ounces of gold is an explicit expression of this intent. Members are, of course, free to reconsider the role of gold in the system. However, we do not understand why this should prevent us from moving forward now in a very limited way based on the current rules of the game.

We proposed that the arrears country be required to replenish any gold sold as a means of avoiding any reduction in the Fund's gold holdings. We recognized that such an approach could require an amendment of the Articles, but believed that this would be an acceptable response to some members' concerns about possible reductions in the Fund's gold holdings. However, if members are opposed to such an amendment, it might be possible to mobilize the gold through other means. Mr. de Groote mentioned one such approach, and the staff may have other ideas.

In conclusion, the mobilization of a limited amount of gold in a highly targeted manner could make an important contribution to reducing arrears while minimizing the immediate, direct cost to other members, and avoiding undesirable precedents that could damage the revolving, monetary character of the institution. As I said on February 2, we are, of course, willing to consider ideas on how to build a better mechanism. However, we remain strongly opposed to financing a rights program from quota resources, viewing it as simple rescheduling. This is especially the case for those of us who have to convince legislatures that new contributions are not being used to make good on past contributions, or more bluntly, that we are not throwing good money after bad. We hope that Executive Directors will consider this option carefully as they examine the various proposals for strengthening the arrears strategy.

Mr. Grosche stated that several Directors remained deeply concerned about the underfinancing of the Fund-monitored program and the prospect that fresh Fund money would be disbursed into a situation of arrears. He firmly believed that the Fund should not be pushed in that direction, and that the support group process would have to be improved upon. The Board should look seriously into the ideas put forward by Mr. Clark and Mr. Filosa in that regard.

A key question remained how to finance the accumulated rights and to keep the country on a sound adjustment track once the efforts of the support groups had been terminated, Mr. Grosche pointed out. He shared the views of those who favored the use of normal quota resources from the General Resources Account for the financing of the rights, provided that a new, regular Fund program would be put in place with heavy front-loading of adjustment measures. The resources of the General Resources Account should then be provided with additional backing, and in that respect he supported extended burden sharing along the lines suggested by Mr. Dawson. In that connection, he wondered whether it would really be necessary to continue, to the extent that had been done in the past, to build up the Fund's special or general reserve to compensate for the impaired liquidity position of the General Resources Account, taking into consideration the fact that amounts from Mr. Dawson's proposal would be placed in Special Contingent Account-2. Perhaps the target amount of net income of 5 percent of reserves at the beginning of the financial year accumulated through the present burden-sharing mechanisms ought to be used to reinforce Special Contingent Account-2 as well, from which rights for the refinance of repurchase obligations from the General Resources Account would be financed.

The volume of rights that could be accumulated under the rights approach that would be financed by the General Resources Account could be quite substantial in some cases, Mr. Grosche observed. Perhaps the rights could be split into two categories, one, for repurchases to be made through a new Fund program--preferably an extended arrangement--and another, for repurchases payable to those creditors and debtors which carried the cost of the nonpayment of charges to the Fund. Perhaps the resources of the structural adjustment facility could be used in the latter case, to stretch out the payment of those obligations, and on concessional terms.

Even if structural adjustment facility resources were to be used in the way he had suggested, the burden of servicing the restructured repurchase obligations on the country should not be underestimated, Mr. Grosche remarked, and the Fund needed to be careful in adding to the amounts to be serviced through additional large access to regular Fund resources. At that point, therefore, resources of the enhanced structural adjustment facility could come into play, to help the country stay on the right track and to continue its structural adjustment policies in the context of higher growth.

He continued to ask himself whether use of the Fund's gold to refinance repurchases was not tantamount to giving a country in arrears access to the

Fund's general resources, Mr. Grosche concluded. Using the Fund's hidden reserves--its gold--in that way would make the General Resources Account less secure. He saw no real rationale for using gold to finance repurchases; he would rather see normal access granted to the Fund's resources in the context of a Fund-supported program, while further strengthening the Fund's liquidity position through the burden-sharing mechanisms. Gold should be in the Fund's reserves for the future. If a country was forced to withdraw because it failed to fulfill its obligations to the Fund, the amount of that country's gold would come to the Fund in any case. It was therefore premature to mobilize gold for arrears, in his view.

Mr. Posthumus said that he had noted that Mr. Dawson had called upon other Directors to reconsider his proposals. He wished to call upon Mr. Dawson's chair to reconsider the proposals, as well as the concerns, of others in a mutually parallel fashion. By linking gold sales to the issue of the quota increase, it might be possible to force the measure through, but he wondered whether that would represent a use of voting rights in the way that had been originally intended. Such a link might lead to problems in the end, because ultimately it would be the national legislatures that would have to approve the quota increase. He hoped that all Directors would keep an open mind about the different proposals that were on the table. He agreed with the Chairman that the issue of the increase in quotas should not be postponed yet again.

The General Counsel, responding to a question from Mr. Kabbaj, said that since, under Mr. Grosche's proposal, the target amount of net income of 5 percent of reserves at the beginning of the financial year which would be used to finance Special Contingent Account-2 would come from the payment of charges, the refunding of amounts from that Account once the reasons for it had disappeared would go entirely to the debtors, because the target amount of net income was not subject to burden sharing.

Mr. Grosche said that he had intended that of the two 5 percent targets for net income, only the one subject to burden sharing would apply, with amounts thus raised used to finance Special Contingent Account-2.

The Deputy Treasurer said that the burden-sharing mechanism covered deferred income for the financial year, on the one hand, and additions to this second contingent account to the extent of 5 percent of reserves at the beginning of the financial year, on the other hand, to take into account the rise in the level of overdue obligations to the Fund.

The External Audit Committee had raised over the previous few years the issue of whether the amounts in the Special Contingent Account were adequate given the size of outstanding obligations to the Fund, the Deputy Treasurer pointed out. Either Mr. Dawson's original proposal to extend burden sharing, or that proposal as amended by the Managing Director, would in effect add to the backing for arrears only in a rather narrow way, because a separate account would be created to cover only the 11 members currently in

arrears. There would seem to be little reason to move the amount of SDR 200 million which had been accumulated in the Special Contingent Account to another special contingent account--Special Contingent Account-2--backing only those 11 cases, when it could not be said with real certainty that other cases of arrears would not emerge, even taking into account the steps the Board was taking to ensure that that did not occur.

Mr. Dawson commented that another aspect of the issue was that the proposal would not raise much money in any case--perhaps SDR 70 million a year.

Mr. Grosche said that he wondered whether use of the Fund's gold would generate significantly more money. Even if the amount was not large, it might still be useful, and might be helpful to certain legislatures in their consideration of the entire package.

Mr. Nimatallah remarked that both 5 percent targets with respect to net income might be placed into the Special Contingent Account. Although the amounts raised might still not be sufficient to support charges of members in arrears, the amounts would be growing, because the amount of overdue charges--to which burden sharing applied--was beginning to surpass the amount of repurchases overdue.

The General Counsel, responding to a question from Mr. Enoch, said that there were limits to the uses to which amounts in the Special Contingent Account could be put because of the vested right of members which provided the resources through burden sharing to have those amounts refunded to them when the Fund determined that the conditions for refunding had been fulfilled. Therefore, the decision as to whether or not to allow those resources to be used in another way or for a different period would lie with the members which contributed them, and not with the Executive Board.

The Chairman commented that a decision at the political level to use the Special Contingent Account resources in a different way would surely presuppose compliance with it by the individual contributors.

The General Counsel observed that the Fund would still need to fulfill its statutory obligations to the Special Contingent Account. Once the amounts were refunded, it would be up to the individual countries which received the refund to decide whether or not to return those amounts to the Fund for another purpose.

In response to a question from Mr. Enoch, the General Counsel said that it might be possible, under the terms of the Special Contingent Account, to change the conditions for future deductions from the rate of remuneration or future increases in the rate of charge, but it would not be possible to change the conditions attached to amounts that had already been contributed to the Special Contingent Account, because of the vested rights of the contributors to receive repayment from the Fund.

The Deputy Treasurer said that each time an amount of deferred income was received by the Fund, the Fund made a refund to Fund creditors and debtors in proportion to the amount of deferred income which had been discharged. At the time the Fund determined that the Special Contingent Account should be dissolved because the problem of arrears no longer required it, then the amounts in it would be refunded to members in proportion to the amounts which they had paid into it under the burden-sharing mechanisms.

Mr. Grosche observed that under Mr. Dawson's proposal for expanded burden sharing, amounts in Special Contingent Account-2 freed up by repayments during the period of the Fund-monitored program could become available for use, if the Board wished to design the mechanism that way.

Responding to a question from the Chairman, Mr. Grosche said that the Fund's reserves, which had been built up over the years as a response to the arrears, were part of the General Resources Account. In that respect, there was no reason why the amounts in the Fund's reserves could not be earmarked specifically for the rights approach, as the final purpose would be essentially the same, and especially if it served to present the Fund's policies to outsiders in a better light. There would be no change in the value of the Fund's assets or financial position.

Mr. Kabbaj said that it appeared that the Board would then be considering using amounts which had been designated as general backing for the Fund for a specific purpose--namely, the settlement of the arrears of 11 countries. Moreover, he wondered whether the amounts in Special Contingent Account-2 would ever be refunded to the contributors.

Mr. Grosche, responding to further questions from Mr. Kabbaj and Mrs. Filardo, said that the only difference between his proposal and the current Special Contingent Account arrangement would be that instead of hiding amounts for the clearance of arrears in the special reserve, those amounts would be brought out into the open and made public. Those amounts would be earmarked for the future access of Fund members which had earned the privilege of encashing their accumulated rights. The refunding would only come later, once the repurchases of the encashed rights had been made.

Mr. Dawson said that he had envisaged that Special Contingent Account-2 would be within the General Resources Account, but not in quite the way that had been suggested in the Managing Director's statement.

Mr. Kafka commented that if the Fund were to sell all of its gold and invest the proceeds in a portfolio of securities which reflected the composition of the basket for determining the rate of interest on the SDR, it would earn a sum annually which should more than make up for any loss

members might feel because of the disappearance of the hidden reserve, and should actually make members feel a good deal safer. He recognized that the argument would be made that that would not be worthwhile if the value of gold were to increase.

Mr. Grosche said that if the Fund did that it would be turning itself into a foundation, and its monetary character would then have to be discarded. Moreover, since the Fund would need to repay members their quotas beforehand, he wondered whether there would be very much money left to invest.

Mr. Yamazaki stated that he did not have much to add to the statement he had made on the previous day, since his authorities wished to give the Managing Director's statement further thought. With regard to the enhanced structural adjustment facility, however, he agreed with the Managing Director's statement made in the morning session. In the case of Japan, lending to the enhanced structural adjustment facility was financed by public resources, including pension funds. His authorities therefore attached the utmost importance to the security of that facility. Furthermore, as his authorities had stressed in individual cases, enhanced structural adjustment facility resources should be used for supporting macroeconomic structural adjustment, and not for the financial restructuring of the borrowing country. He had noted that that view was shared by several Directors, including the U.K. chair. Thus, he would not support financing a rights approach with enhanced structural adjustment facility resources.

He certainly recognized that in the case of Guyana he had supported the Managing Director's intention to propose an enhanced structural adjustment arrangement with some front-loading, against which bridge financing was to be made, Mr. Yamazaki concluded. Although he believed that use of the enhanced structural adjustment facility against bridge financing should be decided carefully on a case-by-case basis, with due consideration given to the repayment capacity of the borrowing country, he did not intend to call Guyana a special case, since the staff had provided assurances that the strengthened preventive and deterrent measures would be applicable to enhanced structural adjustment facility lending.

The Chairman said that strong structural adjustment measures had indeed been part of the program for Guyana. It appeared that one of the elements in the decision of Japan to support financing under the enhanced structural adjustment facility would be the strength of the underlying adjustment program.

Mr. Yamazaki said that his Government believed that use of the enhanced structural adjustment facility in such cases should be considered very carefully. His Government was not prepared to give general consent to the use of that facility, but it also acknowledged that such a judgment needed to be made on a case-by-case basis.

The General Counsel, responding to a question from Mr. Nimatallah, said that Mr. Enoch's idea of retaining amounts presently in the Special Contingent Account that would otherwise have to be refunded to contributors for the purpose of helping remaining arrears cases would not be possible under the terms of the Special Contingent Account, which could not be amended retroactively. However, such a provision could be included with respect to amounts to be placed in that Account in the future, or with respect to a further special contingent account.

The Chairman commented that although he saw the logic of Mr. Dawson's position with respect to the sale of gold to fund rights, such a decision would require an 85 percent majority of the total voting power, which might be difficult to secure, especially when the fact that such a step would be taken only because of a fairly limited problem regarding 11 Fund members was taken into consideration. Mr. Dawson would prefer to apply gold to the funding of the rights; Mr. Grosche would prefer quota resources. If it became clear that a consensus with respect to gold would be impossible, he wondered if Mr. Dawson could see his way to joining Mr. Grosche in supporting the use of General Resources Account resources for funding rights.

Mr. Dawson responded that he continued to see the use of gold to finance rights as appropriate, especially because in mobilizing the gold the Fund would realize the capital gain on the value of its gold holdings above SDR 35 per ounce; unlike Mr. Kafka, however, he would not recommend that the Fund sell all its gold. He realized that there were other sources of financing, but none held such an attraction as gold, in his view, for the reason he had just given. Mr. Grosche's approach would not provide sufficient backing when the volume of the financing that would be involved was taken into account. He believed nevertheless that use of structural adjustment and enhanced structural adjustment facility resources in the financing of rights should be looked into again.

The Chairman said that he would come forward with more concrete proposals with respect to the use of structural adjustment and enhanced structural adjustment facility resources in the financing of rights.

He had one misgiving about Mr. Dawson's approach, the Chairman observed. Mr. Dawson had presented the sale of some of the Fund's gold as allowing the Fund to capture a gain, which could then be used to finance an operation of the institution. In his view, it was not really a gain, because as the amount was being realized a simultaneous reduction in the Fund's hidden reserves was being made. Effectively, it was the use of the Fund's general resources; no new resources were created. He saw the use of gold or the use of quota resources as essentially the same thing. Of course, if the Fund were to be put in a position in which only the sale of gold would enable it to re-establish its financial position, whether because of compulsory withdrawal of members in arrears or another reason, he would not hesitate to recommend such a course, which was defined in the Articles in any case. Nevertheless, he would hope that the steps the Board was

presently taking in the direction of establishing preventive measures against arrears would ensure that such a perilous situation would not occur.

Like Mr. de Groote, he had observed in the present discussion a willingness of Directors to strengthen the voluntary financing of arrears cases, along the lines of Mr. Arora's proposal, the Chairman stated. Such a view had been expressed by Mr. Clark, Mr. Filosa, Mrs. Filardo, Mr. Enoch, and of course Mr. Arora himself. He stood willing to modify his proposal, accordingly. He was in favor of any action that would strengthen the credibility of the support group process. Perhaps those ideas should be discussed further.

Directors might also wish to explore further the points raised by Mr. Grosche and Mr. Enoch about the usefulness of employing enhanced structural adjustment facility resources against General Resources Account resources, the Chairman commented. The staff would try to come up with the relative costs of using General Resources Account resources rather than concessional resources such as those provided by the enhanced structural adjustment facility. The concerns of Mr. Yamazaki would of course need to be observed in that connection. He hoped that Directors would be able to exercise some flexibility so that a final decision on the financing of a rights program could be taken. The other miscellaneous ideas that had been put on the table might merit further investigation as well, including in particular Mr. Filosa's suggestion that a structural adjustment arrangement be put in place following a period in which the country in arrears had established a satisfactory track record, and Mr. Posthumus's idea about the periodic deaccumulation of arrears and their conversion into tranches of a stand-by arrangement.

He suggested that Directors turn to the issue of sequencing in the clearance of arrears, the Chairman concluded. The Director of the Exchange and Trade Relations Department would report on the status of the discussions with the World Bank on that issue.

The Director of the Exchange and Trade Relations Department said that Directors were doubtlessly familiar with the basic issues and the Fund's current position, that, as a general rule, there should be parallel settlement of arrears, with the possibility, in exceptional cases, of considering the sequential clearance of arrears. No sequential clearance of arrears had yet occurred.

Discussions were currently being held with the World Bank on the issue, the Director continued. The Bank's perspective was that the period of three years that was being discussed as the period of the Fund-monitored program under the rights accumulation approach was a very long one for which to secure aid commitments from the aid agencies, which tended to look at their commitments in one-year time periods. Also, given recent experience, the flexibility of the aid agencies to make good on any shortfall had been extremely limited. The Bank believed that if the aid agencies were expected

to become involved in the support groups, they would tend to do so in terms of a succession of one-year programs, and that shortfalls in financing would result which would have to be covered by the international financial institutions, because there would be no residual or fall-back financing available from the aid agencies.

Implicit in the Bank's point of view was the idea that a period of three years for the Fund-monitored program was too long, the Director observed. The views of the Fund's Directors appeared on the whole to be that such a period might be too short. Consequently, if the World Bank was to be expected to respond to shortfalls in the support group financing to make up for the lack of aid agency financing, the World Bank would require the possibility of a sequential clearance of arrears, with arrears to the World Bank cleared first. The staff's view was that that might be sensible in individual cases, provided the World Bank did not thereby cause a net withdrawal of funds; otherwise, the situation would only be worsened, because it would be difficult to see any other source of residual finance.

It had become apparent that the World Bank would have difficulty in disbursing either rapidly or in large amounts to the three or four country cases that were being considered under the rights approach, given the Bank's current procedures, the Director continued. In the first year of the Fund-monitored program, it would appear that some net withdrawal of funds by the World Bank group was likely to occur. The position was further complicated by the fact that both the Fund and the World Bank hoped that if arrears were cleared to the World Bank, the Bank would then be able to contribute not only its own financing, but, especially in the cases of some African countries, Special Program for Africa cofinancing. The question as to whether that funding would indeed be additional, or whether, if it were in some sense coerced, the total amount coming through the support groups would be reduced, could only be assessed in individual cases, and the staff had not yet taken up the issue with the World Bank. In the end it would be a matter of judgment.

The World Bank's concerns with respect to sequential clearance of arrears were the easiest for the staff to ascertain, but it could not be assumed that the World Bank alone was involved, the Director concluded. The question would be raised as to whether the Inter-American Development Bank and certain countries in the Western Hemisphere would not also become involved in one way or another in the sequential clearance of arrears problem. For example, in the case of Guyana, some of the World Bank's disbursements had been channeled through the Caribbean Development Bank, so that the Fund had had to place the Caribbean Development Bank in the category of preferred creditor status with regard to arrears clearance. Similar problems might arise when other arrears cases were addressed.

The Chairman, responding to a question from Mr. Kafka, said that the period of the Fund-monitored program would be about three years.

Mr. Kafka said that he believed that a period of even two years for that program might be too long. He did not wish to retreat from that position.

The Chairman asked why such a period would be too long, taking into account the fact that the program would reinforce the economic structure of the country, which was in the interests of the country itself. Moreover, the program would be assisted by the support group.

Mr. Kafka replied that his view had been influenced by the Board's experience of the case of Guyana, in which the levels of support which even the staff had believed necessary had not been forthcoming. In such a situation it was unlikely that the program of adjustment would be sustained for two to three years.

The Chairman commented that the Board should strive to do better than in the Guyana case in the future. He hoped that the support group process could be strengthened. In that case, perhaps the Board could agree to a period of two years for the Fund-monitored program, as a minimum.

Mr. Kafka commented that if the support groups could be strengthened, there could be no objection to a Fund-monitored program of two, three, or even four years' duration. The Board should not tie itself down to a particular period of time in that regard until it was assured of the strength of the support group process, however.

Mr. Nimatallah said that he agreed with Mr. Kafka. Perhaps it would be better to describe the period of the Fund-monitored program as a range of from two to four years, depending on the case and the evolution of the support group process.

Mr. Posthumus observed that although the World Bank's point of view appeared to be that the Fund should abandon hope of arranging aid commitments of three years' duration, that did not imply that the Fund could not have two-year, three-year, or even eight-year Fund-monitored programs. The problem--the complexity of which should not, nevertheless, be overlooked--was that aid funds would have to be secured year by year, but experience had shown that that was not impossible. For example, the Intergovernmental Group on Indonesia had done that, although not without a permanent struggle. The Fund should not expect a three-year aid commitment from national aid agencies, and should not be disappointed if such a commitment were not forthcoming. It would have to resign itself to soliciting the resources year by year.

The Chairman remarked that perhaps the Fund should request the aid agencies to make firm commitments for one year, with a declaration of their

intention to make later commitments, conditional on various actions. In that way the Fund might demonstrate its flexibility in meeting the aid agencies' concerns in the process of soliciting their support for the rights approach.

Mr. Grosche said that the Fund should insist on the parallel clearing of arrears as a matter of principle, but consider alternatives on a case-by-case basis. He would not want ideology to stand in the way of allowing a program of adjustment to work, if it really proved necessary in some cases to allow the clearance of arrears to another agency first, so as to generate resources for the Fund-monitored program. However, the World Bank should also allow the possibility that the country could clear its arrears to the Fund first--before clearance vis-à-vis the World Bank--if that were necessary to keep the program on track and permit the Fund to continue afterward with a normal Fund program.

Mr. Enoch said that he agreed with Mr. Grosche. He also preferred the parallel clearing of arrears, but with the potential for sequential clearance in exceptional cases. Pragmatism would clearly be needed. The length of the Fund-monitored program would depend on the difficulty of the case, and he could accept that the more difficult cases could take several years. In the case of Guyana, more than a year had passed before the financing had been put together. On a related point, he wished to mention that the Chairman of the Support Group for Guyana had attempted to secure three-year aid commitments, and had been successful in doing so vis-à-vis a number of donor countries.

In some cases--particularly with respect to some African countries--a significantly smaller residual financing gap would occur if the World Bank were allowed to clear its arrears with a country in the first year of the Fund-monitored program, thus allowing the Bank to commit resources for the rest of the three-year period, Mr. Enoch pointed out. He agreed with the Director of the Exchange and Trade Relations Department that it would be hard to judge the degree to which the resources provided through the Special Program for Africa would be truly additional, however.

He agreed with Mr. Grosche that if sequential clearance of arrears were to be allowed, the World Bank should allow for the possibility that arrears to the Fund might, in certain circumstances, be cleared before arrears to the Bank, Mr. Enoch went on. There would also need to be an understanding on the part of the World Bank that it could continue disbursing to a country in arrears to the Fund only if the country were following the Fund-monitored program. There was clearly a risk that the momentum of adjustment might be lost, in that if the country in arrears received a substantial disbursement from the Bank, it might decide to abandon the adjustment effort.

The Chairman said that, taking into consideration Fund-Bank collaboration arrangements, he could not conceive that the World Bank would continue disbursing into a situation in which a Fund-monitored program had been abandoned.

Mr. Posthumus said that the practical result of a three-year Fund-monitored program was that the Fund would require the clearance of arrears after three years. The Fund could not rule out the possibility that a country would arrange some scheme with the World Bank under which its arrears to the Bank were cleared in less than three years, to enable the Bank to make further disbursements. The Fund could not insist then on parallel clearance of arrears, as clearance of arrears only after three years had been originally required under the Fund-monitored program.

Mr. Enoch observed that the arrangements with respect to clearance of arrears to the Fund and Bank would probably be made as a coherent package at the outset, so that the timing of the clearance of arrears would be known in advance. Otherwise, the collaborative process between the two institutions would not work.

The Chairman said that he was certain that a more refined sequencing of arrears payment would be arranged in the case Mr. Posthumus had mentioned. He could not conceive that the Bank would be repaid in one year, and the Fund only at the end of three. In such a circumstance, provisions would have to be made for the Fund to be repaid--at last partially--sooner than three years.

Mr. Nimatallah remarked that the Fund should take the lead in designing the overall package of adjustment and financing for the country following a Fund-monitored program, taking into consideration resources that could be expected from other sources, such as the World Bank and, ultimately, from the country itself. For purposes of visualizing the total amount of resources that might be available, the Fund might establish an escrow account for the program, which would last for the full program period. In that way, the Fund would effectively be fully in charge of the package from beginning to end.

The Chairman said that an escrow account could be useful in certain circumstances, and especially in identifying and, in a way, sequestering resources.

Mr. Dawson said that he agreed with Mr. Enoch and Mr. Grosche that the possibility that arrears to the Fund would be cleared before arrears to the Bank were cleared should not be excluded.

The Chairman said that the Director of the Exchange and Trade Relations Department would convey the comments of Directors on the issue of sequencing to the World Bank.

Directors then took up the issue of the deaccumulation of arrears that had been raised by Mr. Arora and Mr. Posthumus.

Mr. Nimatallah said that the idea was an ingenious one, because it did away with the need for bridge finance to clear arrears. Moreover, it was more straightforward than the convoluted process of using a bridge to clear the arrears, making public the fact that the country had cleared its arrears, and embarking again on another Fund program. Mr. Posthumus's approach would allow for the piece-by-piece deaccumulation of arrears and their conversion into tranches of a stand-by arrangement, which was much simpler. Its only shortcoming was that the element of public announcement--characteristic of the other approaches--would be lost.

Mr. Dawson observed that the deaccumulation of arrears was not a workable proposition.

The Chairman remarked that a number of speakers had shown interest in that idea.

Mr. Posthumus commented that a key difference between the deaccumulation of arrears and straightforward rescheduling--which many Directors objected to--was that under the deaccumulation of arrears Fund conditionality would come into play. That difference should be borne in mind, as conditionality influenced all the Fund's activities.

The Chairman said that the concept of conditionality was indeed an important one, especially in the context of Fund-monitored programs. Mr. Posthumus's proposal might be seen as a further strategy that might be considered in the context of the Fund's flexible approach to solving the arrears problem. He did not believe that it was an unworkable proposition.

Mr. Kafka said he could see no reason for dismissing out of hand Mr. Posthumus's suggestions.

Mr. Grosche said that while he had been attracted to the idea, he had been concerned about the misperception it might create that the Fund was violating its principle of not disbursing into a situation of arrears. Although the Fund would not really be doing so, it was closer to it than the idea of the accumulation of rights which were then encashed out of a special account within the General Resources Account, contingent upon a new, formal Fund-supported program following the Fund-monitored program. Despite his misgivings, however, he would not wish to reject Mr. Posthumus's proposal outright.

Mr. Kafka remarked that he did not understand how the Fund could consider that it was making disbursements to a country in that way, when in effect the Fund would be paying itself. Its exposure would not be increased.

Mr. Arora stated that the problem at hand was keeping members current during the period of the Fund-monitored program. If adequate resources for that purpose were not forthcoming from the support groups, some other solution would be needed to make sure that the program did not then go off track. It was in that light that the deaccumulation of arrears idea should be seen--as an alternative if the support groups failed to fill the financing gaps, so that the arrears would not start to accumulate again.

Mr. Nimatallah commented that even the possibility of rescheduling for the 11 current cases of arrears would not disturb him, since it would be clearly limited to those cases. He would not reject Mr. Posthumus's idea. However, his concern was that, as a catalyst for other resources, the Fund needed to demonstrate that it was attempting to set the country's economy back on track, not that it was interested only in solving its own problem--namely, arrears to the Fund--by any means, including through bookkeeping gimmicks. It was important that others not perceive that the Fund was simply transferring amounts from one side of the ledger to the other--from arrears to prolonged use of Fund resources--otherwise they would be reluctant to provide financing.

Mr. Filosa said that the Board had clearly made progress in its discussions of the arrears strategy, which provided grounds for optimism. Nevertheless, the problem of securing adequate financing from aid agencies remained to be addressed, especially in the context of multiyear Fund-monitored programs.

Another issue was the use of new Fund money or structural adjustment facility resources to make a country current, Mr. Filosa commented. While he did not wish to dismiss ideas out of hand, it might be advisable for the Board not to complicate further the mechanisms in that respect. It was important that the Board not go too far. That being said, he had some misgivings about the proposal on the deaccumulation of arrears.

Mr. Clark called his earlier remark that a key issue was how the Fund could assist countries during the Fund-monitored program, as that was absolutely necessary to make the rights accumulation part of the arrears strategy work. He could not see how the deaccumulation of arrears idea helped the country in that sense.

Mr. Posthumus said that there were two problems. One was ensuring that the support group process functioned properly. The second was how to build up the Fund's position and present how it had addressed the arrears problem in a credible way to the outside world. His proposal was concerned with the latter.

Mr. Clark said he was not sure whether that was not simply creating another veil which disguised the difference between one form of debt and another. He wondered whether the Fund would really appear more credible if it called a sum outstanding as arrears one day, and debt another day.

The Chairman stated that he had been encouraged by the discussion. He had a growing sense that flexibility was developing, and that there was a common desire to institute a credible solution to the arrears problem. The Board should continue its work with a sense of urgency.

Directors agreed to address the topics of how to strengthen voluntary financing in the arrears strategy--including Mr. Arora's proposal and the role of support groups--the financing of the rights approach, the establishment of further special contingent accounts, and financial aspects of compulsory withdrawal on Friday, February 23, 1990.

APPROVED: November 28, 1990

LEO VAN HOUTVEN
Secretary