

INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 89/165

10:00 a.m., December 18, 1989

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

Executive Directors

C. S. Clark
Dai Q.
T. C. Dawson

E. A. Evans

L. Filardo

M. Finaish
M. Fogelholm

G. Grosche
J. E. Ismael

A. Kafka
J.-P. Landau
Mawakani Samba

K. Yamazaki

Alternate Executive Directors

C. Enoch

Zhang Z.

L. Hubloue, Temporary
S. M. Hassan, Temporary
S.-W. Kwon
R. J. Lombardo
G. Garcia, Temporary
N. Kyriazidis
M. B. Chatah, Temporary

O. Kabbaj

T. Sirivedhin
L. E. N. Fernando
G. Bindley-Taylor, Temporary
J.-F. Cirelli
N. Toé, Temporary
M. Al-Jasser
G. P. J. Hogeweg

L. Van Houtven, Secretary and Counsellor
S. L. Yeager, Assistant

1. Debt and Debt-Service Reduction Operations -
Early Repurchase Expectations Page 3

Also Present

IBRD: J. D. Shilling, Cofinancing and Financial Advisory Services Department. Asian Department: M. J. Fetherston. Exchange and Trade Relations Department: J. T. Boorman, Deputy Director; T. Leddy, Deputy Director; E. Brau, S. Eken, B. C. Stuart. IMF Institute: O. B. Makalou. Legal Department: F. P. Gianviti, General Counsel; R. H. Munzberg; Deputy General Counsel; T. M. C. Asser, P. L. Francotte, W. E. Holder, A. O. Liuksila. Research Deptment: K. S. Warwick. Secretary's Department: A. Tahari. Treasurer's Department: D. Williams, Deputy Treasurer; D. Gupta, O. Roncesvalles, G. Wittich. Western Hemisphere Department: S. T. Beza, Counsellor and Director. Personal Assistant to the Managing Director: H. G. O. Simpson. Advisors to Executive Directors: N. Adachi, M. Eran, K.-H. Kleine, P. O. Montórfano, A. Napky, B. S. Newman, D. Powell, A. Raza. Assistants to Executive Directors: B. A. Christiansen, S. K. Fayyad, M. A. Hammoudi, M. Hepp, A. Iljas, C. J. Jarvis, C. Y. Legg, R. Marino, G. Montiel, J. A. K. Munthali, D. Saha, J.-P. Schoder, Shao Z.

1. DEBT AND DEBT-SERVICE REDUCTION OPERATIONS - EARLY REPURCHASE EXPECTATIONS

The Executive Directors considered a staff paper on early repurchase expectations with respect to debt and debt-service reduction operations, together with a proposed decision in three parts--A, B, and C (EBS/89/224, 11/22/89).

Mr. Yamazaki recalled that at the recent Board discussion on the work program (EBM/89/133, 10/11/89; and EBM/89/139, 10/30/89), his chair had urged the staff to accelerate the preparation of a paper on early repurchase expectations in order to facilitate timely debt and debt-service reduction transactions by those indebted countries that had engaged in far-reaching, medium-term adjustment with the Fund's assistance. He therefore welcomed the present discussion and thanked the staff for its expeditious work.

The thrust of the staff paper was appropriate, and he supported the proposed decision, Mr. Yamazaki continued. With respect to the augmentation of arrangements with the Fund for interest support, since members usually had multiple resources that could be used in support of debt-service reduction operations, including their own reserves, it was for them to decide which resources would be used to support such operations when the size of the reduction fell short of expectations. While it was expected that members would not use higher-cost resources and would meet their repayment obligations, it would be appropriate for the Fund to monitor the process in order to ensure the efficient use of scarce resources. Thus, the program review following the debt-service reduction operation should also focus on that aspect.

The staff paper did not touch upon the unused set-aside resources following a debt-reduction transaction, Mr. Yamazaki observed. In his authorities' view, it would overburden the member to make early repurchases in that event, since the set-aside resources were separate from existing access and the member was entitled to purchase those set-aside resources as long as its program remained on track. However, his authorities saw a need to adjust the program accordingly when set-aside resources remained after completion of the debt reduction operations. In most cases, it would be necessary to adjust the reserve target. Therefore, the Fund should be prepared to adjust the performance criteria even before the planned program review, if necessary, when set-aside resources were unused.

Mr. Grosche remarked that in principle, he would prefer to establish an obligation to make an early repurchase in the two instances under consideration. But he concurred with the staff that an expectation would be a more flexible and workable instrument. However, the language in Part A, paragraph 2 of the proposed decision could benefit from some strengthening to underline the presumption that early repurchases should be made. The Managing Director should be advised to recommend other actions only in cases of exceptional hardship.

He recognized that the incidence of early repurchase could not be prevented altogether by using stronger language, Mr. Grosche commented. Prevention had to start from the program's outset, by ensuring that good policies were implemented and that the Fund's resources were made available in tandem with performance. As the guidelines on the Fund's involvement in the debt strategy prescribed, the availability of the set-aside amounts would generally be phased in line with performance, and, where warranted, some front-loading could be considered. The arrangements for those four members with a program under those guidelines contained a clause to the effect that the Fund may agree to accelerate the availability of all or part of the set-aside, and two of the four members had indicated their desire to request such acceleration. He was, however, concerned that what had been meant to be an exception at the very beginning of the strategy had become a rule, thereby adding to the danger that the instrument that was being created would eventually be used. Therefore, he urged a cautious approach with regard to front-loading.

Mr. Hogeweg stated that in considering early repurchase expectations in the context of the guidelines on the Fund involvement in the debt strategy, it was clear that two separate issues were being treated in one decision. In the case of augmentation of access for interest support, where the amount was explicitly additional to access under a stand-by or extended arrangement, the expectation of early repurchase was meant to ensure that the resources would indeed be used for the purpose specified. In contrast, in the case of accelerated set-asides for debt-reduction operations, where the resources were part of access granted in support of the underlying program, the early repurchase expectation was meant to restore ex post the phasing of disbursements in line with performance when a program went off track. Thus, in the first instance, the concern was to ensure the use of Fund resources for a specific purpose; in the second, the concern was adequate safeguards for the use of Fund resources.

The misuse of resources and the risk of a program going off track may occur with respect to both augmented and set-aside resources, Mr. Hogeweg continued. Yet, if a program remained on track, there was no expectation of early repurchase of set-aside resources used for a different purpose. Similarly, if the program went off track, an early repurchase of augmented amounts was not expected. The staff's perspective of the two operations was understandable in view of the different way set-asides and augmentation had been structured. At the same time, it illustrated the artificial nature of those separate instruments to support debt and debt-service reduction operations. Moreover, in the market, the distinction between the debt-stock reduction and debt-service reduction may not be as sharp. It could also be argued that a set-aside may in certain cases entail some additional access; for example, when the strength of the program as well as the balance of payments need had been enhanced by the envisaged debt-reduction operations.

The most difficult consequence of the different treatment of the two instruments might be the expectation of an early repurchase of a set-aside which had been used for the intended purpose but the program subsequently

went off track, Mr. Hogeweg observed. He invited the staff to elaborate further on the different treatment of the two instruments and its possible consequences.

The establishment of an expectation, rather than an obligation, to make an early repurchase was acceptable, although an obligation would provide a stronger basis for uniform treatment of members in similar situations, a point to which he attached great importance, Mr. Hogeweg remarked. If there was sufficient support in the Board for the establishment of an obligation, he would prefer that approach.

The decision seemed to allow considerable leeway with respect to the handling of individual cases, in terms of the actions to be taken and the length of time within which to effect the early repurchase, Mr. Hogeweg considered. He could agree to the decision on the presumption that early repurchases would be effected in relevant cases in a timely manner. He wondered whether the 90-day period allowed to bring a program back on track prior to the Managing Director's report to the Board in the case of set-asides was not unduly long. He strongly supported the provision that a member which failed to effect the expected early repurchase should not be allowed to use the Fund's general resources.

Mr. Evans remarked that he agreed with the staff that the Board's consideration should be limited to an expectation, rather than an obligation, to make an early repurchase. Moreover, he agreed with the staff's proposal for the establishment of an expectation in the case of additional resources for interest support. The agreed guidelines on the Fund's involvement in the debt strategy provided for such provisions; and the circumstances, as suggested by the staff, in which such an expectation might be established seemed entirely reasonable. He could therefore support Part A of the proposed decision.

The staff's proposals relating to set-asides, however, was far from clear-cut, Mr. Evans considered. The agreed guidelines did not provide for an expectation of early repurchase in the event of the acceleration of set-asides, and in that connection, he did not join those colleagues who had argued strenuously that the agreed guidelines must remain unchanged at the present stage; in his view, accepting the proposed changes might provide the precedent for other, more soundly based, amendments to the guidelines. Moreover, the basic rationale of the enhanced debt strategy relied upon a quantum change in debt-service obligations, sufficient to enhance a debtor's relations with the international financial community. It was clear from the outset that allocating 25 percent of a quarterly or half-yearly purchase under a stand-by or extended arrangement would not achieve that objective. For that reason, in each of the four requests that had been considered to date, the Board had agreed to an acceleration of set-asides. Such acceleration, therefore, could not be considered as exceptional; rather, it gave credence to the guidelines when seen in the context of the rationale underlying the debt strategy. Hence, as some acceleration of set-asides was the norm, no special provisions should be made for their early repurchase.

The acceleration of set-asides must be approved by the Board following its review of the debt-reduction package negotiated by the member with its commercial creditors, Mr. Evans observed. The Fund was therefore not looking at purchases where--as the staff had suggested--the Fund's resources would be subject to greater risk than under the original schedule of disbursements. In that light, he wondered how a distinction was to be made between accelerated set-asides and front-loading, which gave rise to no early repurchase expectation. He also noted that the early repurchase expectation would arise only if a program went off track--an event which would, of itself, curtail further purchases. Thus, under the proposed approach, when a program was derailed owing to failure to meet an external reserve criterion, for whatever reason, a member would be short of reserves, denied further purchases to augment reserves, and required to make an early repurchase, thereby further depleting its reserves. That approach seemed to be a recipe for creating new cases of arrears to the Fund.

The staff may have anticipated those problems in its proposal to provide the Managing Director with discretion to recommend to the Board an early repurchase or "such other action as may be appropriate," Mr. Evans commented. Such discretion would appear essential, but it would also reduce the proposal's effectiveness, including as a deterrent. In that light, the proposal in respect of accelerated set-asides would serve the purposes of neither creditor nor debtor, and he could not support it.

Mr. Kafka remarked that he agreed with Part A of the proposed decision but was opposed to Part B, which dealt not with a deliberate diversion of Fund resources, but only a changed phasing of disbursements. The latter entailed a risk--if it was a risk--which the Fund could legitimately, and should, run in order to avoid a further weakening of the debt strategy.

The diversion of augmented resources in circumstances such as those contemplated under Part A of the proposed decision was similar to a non-complying purchase and should be punished, Mr. Kafka considered. That was not true for purchases dealt with under Part B. He therefore proposed to delete Part B and to modify Part C--which would become Part B--accordingly.

Mr. Cirelli remarked that beyond the legal and procedural aspects, the proposed treatment of additional resources for interest support and set-aside amounts raised important questions. The Fund's guidelines had to be precise, and the considerations set out by the staff were a necessary attempt to reconcile the protection of the Fund's resources with preserving the effectiveness of the innovations introduced in its guidelines. The procedures described by the staff, although complex, dealt with those two preoccupations in a balanced way, and he was in general agreement with the thrust of the staff's proposals.

He agreed that the establishment of an expectation of early repurchase was better than an obligation, Mr. Cirelli continued. Even if

the establishment of an obligation was, in the abstract, a more logical solution, there greater flexibility offered by the staff's proposal would leave more room for a case-by-case judgment, while providing appropriate protection for the Fund's resources and sanctions against their misuse.

He supported the proposed procedure with respect to additional resources for interest support as a simple and transparent approach for the Board's appraisal of possible misuse of Fund resources, Mr. Cirelli stated. As to the proposed procedure with respect to an accelerated disbursement of set-aside amounts, the Fund had to be prepared to face more complexity, in view of the wide range of events which could occur during the implementation of a program under a stand-by or extended arrangement. He could support the general design of the procedure because the matter would be brought before the Board within a short period after the program had gone off track. In that regard, he stressed that informing the Board of developments in a timely manner was a key element. Moreover, the procedure allowed the Board to exercise flexibility in determining the choice of sanctions, and the amount to be repurchased. In that connection, he wondered why the misuse of set-aside amounts had been considered.

In sum, he could go along with the proposed decision, which provided a precise framework to protect Fund resources in support of debt-reduction operations, Mr. Cirelli commented. The Board would thereby be able to better assess the risks involved and would have the means to react quickly when circumstances warranted. With respect to protecting Fund resources, he wondered what were the prospects for establishing an escrow account for that purpose.

Mr. Lombardo remarked that he understood the concern of some Directors regarding the need to protect accelerated purchases and amounts set aside under Fund arrangements to support debt-reduction operations. He also understood the rationale for the provision in the guidelines which specified that a member country would be expected to make an early repurchase of augmented amounts to the extent that it did not use those resources as intended. In his view, the current guidelines on the Fund's involvement in the debt strategy, together with the Articles of Agreement, already provided a flexible framework within which management and the Executive Board could, on a case-by-case basis, appropriately handle those cases which might require an expectation of early repurchases. He was not convinced, therefore, of the need to adopt an explicit decision to deal with such situations. If, however, the majority of the Board deemed it necessary to require an explicit decision, he would favor establishing an expectation, rather than an obligation, to make an early repurchase.

He agreed with the staff that an obligation would inhibit overall flexibility, thereby limiting the Fund's ability to provide financing for debt and debt-service reduction operations, Mr. Lombardo commented. Furthermore, a decision simply specifying that an early repurchase was expected would sufficiently safeguard the Fund's resources. He did not, however, see the need for the Fund to attach some of the same consequences

that were included in a breach of a repurchase obligation, to a breach of a repurchase expectation. Consequently, the General Provisions included in Part C of the proposed decision were unnecessary. He would appreciate some additional comments from the staff on that point.

Mr. Dawson made the following statement:

The staff proposals to establish an expectation of early repurchase for interest support and accelerated set-asides for debt reduction represent a marked departure from traditional Fund practice. It is my understanding that expectations of early repurchase have been used only sparingly in the past and never simply because a member's program has gone off track. While my authorities understand the special circumstances that have led to the staff's proposal, they have some doubts as to whether the blanket authority being proposed is necessary and believe that, at a minimum, some safeguards need to be built into the decision to avoid exacerbating the very problem that the staff's proposal seeks to address.

With respect to early repurchase requirements in connection with interest support transactions, the guidelines on Fund involvement in the strengthened debt strategy clearly envisage early repurchase in the event that interest support funds are not used for their intended purpose. However, it is not clear what the staff has in mind regarding the circumstances that would trigger the expectation of an early repurchase. In particular, disbursements to an escrow account for interest support would only be made when specific interest reduction transactions had been agreed between the member and the commercial banks. Moreover, we would anticipate that the banks would insist that the escrow account be structured in a manner to assure that the funds could only be withdrawn for the intended purpose. Finally, the Fund's current rules governing early repurchase in cases of noncomplying purchases would appear to cover a situation where an interest support purchase was not used as intended. Consequently, I would appreciate a clarification from the staff regarding the specific instances where the expectation would be triggered and why it is necessary to have a safeguard mechanism beyond the provisions in Article V and the decision on noncomplying purchases.

As to an early repurchase expectation with respect to accelerated set-asides, under the strengthened debt strategy, the acceleration of purchases of set-aside resources was intended to facilitate debt-reduction transactions where the volume of such operations proved to be greater than would have been feasible under the normal phasing of Fund disbursements. The use of Fund resources for this purpose would strengthen the financial position of the member and therefore would reduce risks to the Fund. Moreover, the acceleration of set-asides

could take place only after the Executive Board's review and a decision based on a recommendation by the Managing Director, which included a report on the implementation of the member's program.

The scope for accelerated purchases provides increased flexibility to enable the member to take advantage of a larger volume of debt-reduction transactions without drawing down other resources that may already be constrained owing to balance of payments problems. The acceleration of set-asides is akin to front-loading of programs where the Fund provides a disproportionate share of its resources at the outset when the financing pressures and risks are greatest. In effect, acceleration differs from front-loading only in that it would occur after the first disbursement. The increased exposure by the Fund is likely to be modest and short-lived when compared with the normal phasing and front-loading of programs. In these circumstances, I wonder why the staff seeks additional safeguards with respect to accelerated set-asides when they are inherently less risky than the usual form of front-loading.

Presumably, the addition of an expectation of early repurchase is designed to enhance the Fund's leverage to obtain additional policy measures in the event that a program goes off track. My authorities believe that the Fund already has sufficient leverage through the suspension of purchases. An expectation of early repurchase would simply increase financial pressure on the member to draw down other resources and/or go into arrears to other creditors.

My authorities recognize and share the concern that the Fund not be perceived as taking on a disproportionate share of the financing burden. Moreover, they also accept that acceleration provides the borrower with some modest increase in flexibility not available in other Fund purchases. Therefore, my authorities would be prepared to consider some additional safeguards if they are not inconsistent with the intentions of the strengthened debt strategy. In particular, early repurchase for accelerated purchases should not be viewed as a punitive measure or result in unwarranted financial pressures owing to problems that may have nothing to do with the member's efforts.

In this connection, the proposed decision with respect to accelerated purchases should be modified to limit the early repurchase expectation to purchases that are accelerated by more than one year; permit a period longer than 30 days to effect the early repurchase in the event that the payment would involve undue hardship on the member; and limit early repurchase to situations where the program is off track primarily owing to the member's failure to implement agreed policy measures rather than

those situations where the program objectives are not met due to unfavorable external developments.

Mr. Clark stated that his authorities had been concerned for some time about limiting the risks to be borne by the Fund as a result of the front-loading of resources in support of debt and debt-service reduction operations. He concurred with the staff that when a member's access to set-asides was accelerated to accommodate market-based, debt-reduction operations and the program subsequently went off track, the Fund should have the right to call upon the member to restore the situation that would have prevailed had there been no acceleration. Similarly, he also agreed that if a member country was given access to additional resources to be used for interest support, the Fund should be in a position to call upon the member to make early repurchases if the member did not use all or part of those resources for the specified purposes within the specified time period.

The staff had made a persuasive case in favor of incorporating an "expectation" of early repurchase in a Fund arrangement rather than instituting an obligation of early repurchase, Mr. Clark considered. The establishment of an expectation would indeed appear to be more flexible and would offer many of the same safeguards as an obligation. A failure to meet an expectation of repurchase had legal consequences, although in practice, in most circumstances, the Fund would only be likely to suspend the member's right to make further purchases under the arrangement or any subsequent arrangement until the repurchase expectation had been met.

The staff's view that it would be difficult to prove that a member's use of additional resources for purposes other than interest support operations was contrary to the "purposes of the Fund"--namely, grounds for a declaration of ineligibility to use the general resources of the Fund under Article V, Section 5--was somewhat surprising, Mr. Clark commented. The Fund would not approve a request for, and a subsequent purchase of, those resources if they were not to be devoted to support interest payments in connection with debt or debt-service reduction. Therefore, an argument could possibly be made that in such cases, the purposes of the Fund could be defined narrowly--namely, as encompassing only the support of interest payments in connection with debt or debt-service reduction. Such an interpretation would mean that a declaration of ineligibility could be applied relatively easily and would not involve a large judgmental element, as the staff's interpretation would require.

Under the staff's proposal, if a member's program should go off track, 120 days or more might elapse before an early repurchase of accelerated set-asides would need to be effected, Mr. Clark observed. While it was desirable to allow some time for discussions with the Fund regarding steps to bring the program back on track, the time frame proposed by the staff appeared somewhat protracted.

Mr. Fogelholm stated that he could support the rationale for establishing an expectation, rather than an obligation, to make an early repurchase in instances where Fund resources had not been used for debt or debt-service reduction operations as specified, or where Fund-supported programs had gone off track. As to the specific categories for which an expectation of early repurchases were proposed, he had reservations, particularly with regard to coverage. For instance, in cases where the program was on track but the set-aside amounts had not been used in accordance with the Board's decision, he believed that the guidelines on Fund involvement in the debt strategy dictated that the situation should be treated in a manner similar to that for the misuse of additional resources. The reason for not covering such cases of misuse would seem to be that the set-asides were an integral part of the credit tranche. Nevertheless, he believed that the Board should adhere to the guidelines, and accord such cases a specific subparagraph under Part B of the decision. With that exception, he could support the proposed decision.

Mr. Enoch made the following statement:

Most of the staff's proposals seem to be generally sound, although the question of whether members should be merely expected, rather than obliged, to make early repurchases is not clear-cut. Where additional resources are disbursed and then not used for interest support, there would seem to be some case for obliging members to make early repurchases. The only reason such funds are to be disbursed in the first place is for interest support operations. If they are not then used for interest support, it is not clear why the member concerned should have any claim on them at all.

I can, however, appreciate the force of the staff's arguments about the lack of flexibility that might result if members are obliged, rather than expected, to make early repurchases. For instance, it is conceivable that an interest support arrangement might not be exactly as specified at the time of the disbursement of additional resources. In that event, it might be difficult to provide for appropriate Board procedures to be followed to prevent the obligation to repurchase from taking effect. I can therefore agree to the decision regarding the expectation of repurchase, but with the reservations already noted by Mr. Grosche and Mr. Hogeweg.

The situation with respect to accelerated purchases of set-aside amounts is somewhat different. I wonder indeed with Mr. Hogeweg and others whether there is a gap in the staff paper. The staff considers the possibility that interest support resources might not be used for the purpose intended, but it does not consider the possibility that set-aside resources might not be used for their intended purpose. There are two possibilities here. First, set-aside resources, including accelerated disbursements, might not be used at all, if, for

example, an agreement with the commercial banks fell through. Second, set-aside resources could be used, but in ways inconsistent with the guidelines. The question would then arise as to whether there should not be an expectation of early repurchase in these cases. While the argument could be made that a member would have received set-aside resources anyway, if it had chosen to do so, this clearly does not apply to accelerated set-aside resources. However, apart from the acceleration question, the Board has, in its guidelines, laid down specific conditions under which set-aside resources can be used. The expectation to repurchase should not take effect until steps have been taken to try to bring the program back on track. The rather longer time periods for consideration by the Board suggested in the proposed decision therefore seem appropriate.

In light of this, I would welcome staff comments on whether there should also be an expectation for members to make early repurchases either of all set-aside amounts in cases where they are not used as specified or of accelerated set-aside resources. In either case there would have to be an addition to the proposed decision.

The staff paper does consider the case where a program has gone off track, presumably after a debt-reduction operation has been completed. In such cases, the staff proposes an expectation that the members will make early repurchases of accelerated set-asides. I can understand Mr. Evans's concerns on this point. The remedies proposed in the decision will clearly come in to play only if there is a breakdown either in the program or in debt-reduction operations which have been agreed between members and their creditors, and for which the use of Fund resources has been approved by the Board. I would, of course, hope that such a situation can be avoided. The best protection for both the interests of members and for the Fund's own resources lies in the design of strong and sustainable adjustment programs, in the design of workable, debt-reduction operations, and in the commitment of Fund resources only when the modalities of the operations are absolutely clear.

Mrs. Filardo stated that she understood that Mr. Enoch would like to accelerate repurchases when the set-aside resources were not used for the debt-reduction operation for which they had been designated. In her view, the set-aside resources were intended for balance of payments purposes, and if the member did not use them in the context of debt-reduction operations, it should not have to make an early repurchase.

Mr. Enoch remarked that in his view, if the Board had approved a program involving the use of certain resources for set-asides and if those resources were not used for the purpose specified, they should no longer be available to the member. If a member had decided that it did not wish

to use set-aside resources for debt-reduction operations, it could presumably have negotiated a different program to be supported by the same total amount of Fund resources. It would be inconsistent to use the resources set aside for one part of a program to finance another part of a program. When the member decided to request set-aside resources, it did so in the context of a particular Fund program.

The Deputy Director of the Exchange and Trade Relations Department confirmed Mrs. Filardo's understanding that the arrangements for some members clearly stated that if the member did not use the set-aside resources for debt-reduction operations, it could request the use of those resources for balance of payments purposes. The Executive Board would, of course, have to take a decision to release the set-aside resources, based on an analysis of the member's request.

Mr. Dawson remarked that the point was that set-asides were for a purpose, and if they were not used as intended, the question of their appropriate use would have to come back to the Board. He would appreciate a clarification by the staff of how a misuse of set-asides could occur, since they presumably would be released for an agreed purpose.

The Deputy Director of the Exchange and Trade Relations Department observed that no disbursement of funds for debt reduction or interest support had yet been made, and the staff still did not know how the operations would be structured. With respect to the augmented amounts, the intended purpose was collateralization for interest support. In practice, the operations may be so well laid out that the staff would know precisely what was going to happen, and exactly when it was going to happen, so that there would be no practical question of using the funds for a purpose other than that specified. But even so, as the Fund would be disbursing in advance of the operation, it was conceivable that something could happen between the disbursement and the intended operation. That aspect had been cause for concern to the Board at the time when the guidelines were established, and the staff's present proposal simply tried to give operational effect to that element of the guidelines. It was possible that a misuse of augmented resources would not arise in practice, but the staff could not know with certainty that the funds would in all cases be used for the purpose intended, namely, interest support.

The same question could arise with respect to set-asides, the Deputy Director of the Exchange and Trade Relations Department remarked. But as a number of Executive Directors had noted, set-asides were in fact part of the resources available under the arrangement, and thus would have been available, as originally scheduled, in the absence of debt-reduction operations.

Mr. Dawson observed that a misuse of resources in respect of a set-aside would be covered under the provisions relating to noncomplying purchases and therefore no additional provision was needed.

The General Counsel remarked that a noncomplying purchase--a purchase made on the basis of inaccurate or false information concerning the compliance with a performance criterion--was different than a misuse of resources. In the case of a misuse of resources, the facts presented were accurate, the performance criteria had been met, but the member had diverted the resources to a different purpose. While a sanction for misreporting was provided in the Fund's guidelines on noncomplying purchases in the form of a repurchase expectation, which, if it was not fulfilled, could give rise to a declaration of ineligibility under Article V, Section 5, no similar sanction was provided for a diversion of funds from their intended purpose.

That dilemma had been put to the staff when it was asked to work on additional safeguards for possible misuse of Fund resources, the General Counsel recalled. One possibility, of course, would have been to rely exclusively on Article V, Section 5, and to declare the member ineligible for use of the Fund's resources inconsistent with the Fund's purposes. That provision, however, was essentially judgmental in the sense that it was for the Executive Board to determine, on the basis of all the circumstances of the actual use, whether the member had misused the resources provided by the Fund.

In view of the Board's interest in strengthening the approach toward Fund support of debt and debt-service reduction operations, the proposed decision tended to take a more objective approach, the General Counsel observed. Under that approach, if the member used the resources provided by the Fund for any purpose other than the purpose approved by the Fund, there would be prima facie evidence of a misuse of Fund resources. It was possible, however, for the Executive Board, in the light of all the circumstances, to decide not to impose a repurchase expectation. Creating that expectation should not be viewed as reversing the burden of proof because the expectation would arise only with evidence of misuse.

Mrs. Filardo observed that a repurchase expectation with respect to set-asides gave rise to a dilemma: once the Board had approved a member's arrangement with its commercial bank creditors, it could ex post find that the debt reduction operation had resulted in a misuse of Fund resources. She wondered whether it would be possible for the Board to evaluate and approve the proposed use of the set-aside ex ante and thereby avoid the emergence of any problem of misuse.

Mr. Toé remarked that the staff paper put forward convincing arguments in favor of establishing an expectation of early repurchase, rather than an obligation, in the two instances under consideration. The staff proposal struck a balance between the need to safeguard the Fund's resources and the interest of member countries by avoiding the introduction of rigidities in the guidelines on the Fund's involvement in the debt strategy. Nevertheless, he was concerned about some aspects of the proposal, namely, the length of the prescribed period for bringing a derailed program back on track and for making the early repurchases pursuant to a Board decision on the matter.

The experience of countries in his constituency was that 90 days was too short a period for initiating discussions on a derailed program, setting a new test date and performance criteria, and ascertaining compliance with those performance criteria, Mr. Toé continued. However, the flexibility embodied in the staff proposal, which allowed the Managing Director to grant an extension when justified, had helped to allay his concerns. In making that point, the intention was to emphasize the need to exercise flexibility in the implementation of the decision so as to take into account reasonable delays that may occur in negotiations with member countries.

He had no difficulty with Part A of the proposed decision, Mr. Toé commented. However, he had difficulty with Part B regarding accelerated repurchases of set-aside amounts, and the general provisions contained in Part C. Those provisions equated an expectation of early repurchase in respect of set-asides with that in respect of a noncomplying purchase. He preferred to have the same expectation of early purchases as in the case of overcompensation for an export shortfall under the compensatory and contingency financing facility. It should be kept in mind that in the case of an accelerated purchase of set-aside amounts, the resources would probably have already been used to effect debt reduction. Therefore, like Mr. Kafka, he would prefer to delete Part B of the proposed decision. Moreover, Part C should be modified. He shared most of the views expressed by Mr. Dawson, particularly with respect to the extension of the 30-day period for making early repurchases, and the distinction to be made between the causes of the program going off track. With those amendments, he supported the proposed decision.

Mr. Hassan stated that he agreed that the Fund should take necessary measures to protect its resources and ensure their appropriate use and timely repayment. In principle, he supported the incorporation of early repurchase provisions in the two proposed cases. However, he was somewhat concerned about the possible implications of a mechanical application of such provisions regardless of the circumstances of individual countries and the specific factors that gave rise to a repurchase expectation.

He shared the staff's view that an expectation of early repurchase, while providing the needed protection for Fund resources, would offer a flexible and much simpler instrument than an obligation, Mr. Hassan considered. He therefore agreed that an expectation of early repurchase would be the more appropriate option. His main concern was that the specific circumstances leading to the situation might not be given due attention. For example, in the case of augmented resources for interest support, the factors leading to the inability of the country to use the resources for the purpose intended within a specified period of time should have an important bearing on whether the country was expected to undertake an early repurchase. If, for example, the failure was due to the reluctance of commercial banks to cooperate with the country, the more appropriate course may be to exempt the country from an early repurchase requirement. He had similar concerns with respect to accelerated

disbursements of set-aside amounts in the event that the member's program went off track. If the failure of the country to comply with the program's performance criteria or benchmarks was due to factors beyond its control while it had implemented all policy measures required under the program, he would find it difficult to ask that country to make an early repurchase of the accelerated set-asides.

Mrs. Sirivedhin remarked that in general she could go along with the proposal for the establishment of an expectation of early repurchase in the first of the two cases discussed in the staff paper. The establishment of an expectation rather than an obligation would give the Fund sufficient protection of the temporary nature of its resources and at the same time provide enough flexibility so that actual decisions could take into account the particular circumstances of each member. For practical purposes, the member would be no less obliged to make the repurchase under either case.

With respect to set-asides, it may be undesirable to establish even an expectation of early repurchase, Mrs. Sirivedhin considered. When a program went off track, further drawings would automatically become unavailable. The establishment of an expectation in addition to the suspension of disbursements may place undue hardship on the member and give rise to a situation that the debt-reduction operation was intended to correct or avoid.

Mr. Al-Jasser remarked that the proposed decision was reasonable and gave operational effect to the existing guidelines with respect to early repurchase in connection with debt and debt-service reduction operations. It sought to minimize the risk inherent in any augmented or accelerated purchases. Moreover, it introduced a measure of flexibility in that it proposed the establishment of an expectation rather than an obligation. The flexibility embedded in the provision, namely, that the Managing Director would at the end of the 90-day period submit a report to the Executive Board recommending whether the member should be expected to make an early repurchase, was particularly reassuring. Hence, the interests of the Fund and the member were well addressed and the case-by-case judgment of the Board was reaffirmed. He therefore supported the proposed decision.

Mr. Kyriazidis stated that while an expectation of early repurchase had the appearance of a punitive measure, he viewed its use as preventive rather than punitive. In that light, he could support the proposed decision in principle, subject to some reservations.

He agreed with Part A of the decision, Mr. Kyriazidis continued. It was clear that in the case of misuse of Fund resources, an expectation of early repurchase was appropriate. The idea of misuse, however, was somewhat fuzzy, as Mr. Dawson had pointed out. He wondered how it could be updated within the general framework of a program in which Fund resources were being used in support of balance of payments, resources were fungible, and it was difficult to determine the use or misuse of a

specific amount of resources in relation to the balance of payments. He could go along with Part A, as a matter of principle. He had some difficulty, however, with the contradiction between Parts A and B that had been pointed out by Mr. Hogeweg, Mr. Cirelli, and Mr. Fogelholm. That should be eliminated. He also had considerable sympathy for the views expressed by Mr. Evans and Mr. Dawson regarding, more specifically, the expectation of early repurchase of accelerated set-asides in cases where the program went off track even though the resources had been used for the intended purpose. He could, however, go along with the proposed decision in view of the flexible procedure that it provided, but the adjustments proposed by Mr. Dawson were eminently desirable in the framework of a preventive clause such as the one to be introduced into future arrangements.

Mr. Hubloue stated that he could support the proposed decision as it stood, because it struck an appropriate balance between too much rigidity and too much flexibility. He also agreed with the general thrust of Part B of the decision; without it, the Fund might have to become excessively prudent with respect to accelerated disbursements.

On the comparisons that had been made between accelerated set-asides and front-loading, he had had the impression that the criteria for accelerating disbursements were quite different, and more technical than those that might justify front-loading of disbursements in certain conditions, Mr. Hubloue commented. He would appreciate staff comment on that point.

Mr. Kabbaj stated that he shared most of the views expressed by Mr. Dawson on the proposed decision. In general, the decision lacked flexibility and was too mechanical. He would have preferred to see more flexibility granted to management and the staff to deal with all cases that could arise. As it stood, the decision would further complicate the already complex implementation of the debt strategy. Moreover, it did not pay due regard to cases where programs went off track because of circumstances beyond the control of the authorities.

The 90-day deadline for bringing a program back on track was too short in view of experience with reviews, Mr. Kabbaj commented. The deadline for effecting the early repurchase--namely, 30 days--was also too short. Moreover, there were other reasons why set-asides might not be used within the specified time period. For example, he could envisage the case of complications in negotiations with commercial banks as had been evidenced by recent cases. On Mr. Enoch's proposal to extend the provisions to set-asides that were not accelerated, he agreed with Mrs. Filardo that the set-asides were part of normal access to Fund resources, and thus, there was no compelling reasons to apply the proposed decision to them. On balance, he took the same position as Mr. Kafka on the proposed decision, namely, that Part B should be deleted.

Mr. Garcia remarked that in general, he agreed with the staff's view that an expectation was better than an obligation, for two reasons. First, it provided more flexibility for a case-by-case analysis, and the debt strategy required that type of focus. Second, it was an appropriate

approach for the Board, because a decision could be taken by simple majority of the total voting power, and it was also consistent with the guidelines for Fund support of debt-reduction operations whereby a simple majority of the total voting power, could approve a package, the acceleration of the set-asides, and the augmentation of resources.

He would like the staff to elaborate on misuse, Mr. Garcia commented. He understood that once the debt-reduction operation was completed, the staff would provide the Board with an assessment of the operation and that, in the event of misuse, the Board would have to take the steps necessary to protect its resources.

As to the proposed decision, he shared the observations made by Mr. Dawson, particularly with respect to two principal aspects, Mr. Garcia continued. First, the 30-day period specified for a country to make a repurchase might be too short, particularly in the absence of an analysis of the reasons why the program went off track as well as the resources available to the country at the moment the program went off track. In that regard, the staff's proposal did not reflect the desired degree of flexibility. For example, the Board might establish a certain interval of time during which the country had to make the repurchase, but that should be done on a case-by-case basis and taking into consideration the countries' particular circumstances, so as to avoid inducing the country to fall into arrears to the Fund and thereby worsen its situation. He would therefore like to consider that point in more detail.

As the guidelines intended that the Board should have enough flexibility to consider each specific case, the proposed decision should mention clearly that consideration should be given to the reason why the program went off track, Mr. Garcia concluded. Moreover, the 30-day period to effect a repurchase was too short. If, however, account was taken of the particular circumstances which caused the program to go off track, he could support the proposed decision.

Mr. Dai remarked that he had no major problem with the proposed decision and therefore had only two comments to offer. First, since the strengthened debt strategy was still in the initial, experimental stage and experience was as yet insufficient, the proposed decision could be viewed as complementary, but on a trial basis, and he believed that it was reasonable to subject it to review after a period of implementation. Regarding the early repurchase of set-aside amounts, he agreed with several Directors that in making a judgment regarding the nonobservance of certain criteria, the causes of the failure should be fully taken into account.

Mr. Chatah remarked that he supported the rationale underlying the proposals, namely, the need to safeguard the Fund's resources in a period of enhanced Fund involvement in the strengthened debt strategy. However, he saw potential problems with respect to programs that went off track. The uniform application of an expectation of repurchase would have certain pitfalls, while undue flexibility would create excessive uncertainty and

would be counterproductive. Moreover, he was not certain that it was necessary to adopt provisions at present, especially as the interest support packages were still unclear. To the extent that such provisions were necessary, he would be prepared to support them.

One issue that needed further clarification was the operational guidelines for determining misuse, Mr. Chatah commented. In view of the number of sources of funding for interest support, the logistics, and sequencing, it may not be fully transparent that all or part of the Fund's resources had not been used for the intended purpose. That aspect should be made more transparent in the proposed decision.

Mr. Fernando observed that some speakers had expressed interest in establishing an obligation rather than an expectation. An 85 percent majority of the total voting power was required for a decision to accelerate the due date of a repurchase obligation under Article V, Section 7(d). He wondered whether such a decision was binding only with respect to future purchases. If it did not apply to purchases already made, then the establishment of an obligation would be totally impracticable.

Mr. Al-Jasser remarked that his support for the decision was based on the perception that the decision provided flexibility in determining why the program had gone off track, and in the event that it was due to circumstances beyond the member's control, the Managing Director's report to the Board would suggest whether an expectation of early repurchase should be adopted. He further understood that the report would be made 90 days after the program had gone off track and that the repurchase would be made within 30 days of a decision on early repurchases, which meant that there would be 120 days of continuous negotiation between the Fund and the authorities to see if the program could be brought back on track. He would like the staff to confirm that his understanding of the decision's flexibility was correct.

The Deputy Director of the Exchange and Trade Relations Department stated that the staff's proposals were meant to facilitate the Fund's involvement in the strengthened debt strategy by providing some modest additional protection to the use of the Fund's resources. In that context, he wished to assure Directors that the proposals were in no way intended to be punitive. In formulating the proposals, the purchase of additional resources for interest support and the accelerated purchase of set-asides were viewed as fundamentally different. The augmentation of an arrangement was justified only if the resources were used for interest support. Moreover, in the guidelines, there was no presumption that the augmented resources would necessarily be phased. In contrast, purchases of set-aside amounts were to be phased in line with program performance. While the distinction between augmented and set-aside resources may, to some extent be artificial, it was fundamental in the sense that under the guidelines, augmented resources were additional to the amounts otherwise available to the country under the enlarged access policy.

A number of Directors had commented on flexibility and the judgmental nature of the provisions, the Deputy Director recalled. The staff had started with the idea that an obligation should be established for the reasons outlined in its paper, which echoed to a considerable extent the views of Directors at previous Board discussions. In the end, the staff had decided that it would be best to propose the establishment of an expectation rather than an obligation, and that the expectation be subject to a determination by the Board, on the basis of a report by the Managing Director, in light of all of the circumstances of the case, including whether the program had gone off track because of policy shortfalls or whether it had gone off track because of external circumstances.

A 90-day period to bring a program back on track in the case of the set-asides was considered reasonable, in view of the lags that may occur in data availability as well as the time required for consultations with the member, the Deputy Director continued. Both of the periods specified--90 days and 30 days--were subject to modification depending on what was proposed by management and what was decided by the Executive Board. Thus, there was a further element of flexibility with respect to timing.

With respect to the distinction between set-asides and front-loading, there was provision within the guidelines for some front-loading with specific reference to the set-aside amounts, the Deputy Director of the Exchange and Trade Relations Department commented. Compared with the general criteria for front-loading, the guidelines for set-asides contained the potential for the acceleration of purchases in excess of normal front-loading within the Fund's standard practice. For example, a request for the acceleration of set-aside amounts under the extended Fund facility could result in an effective front-loading of 40-50 percent of the entire three-year arrangement very early in the program period. The provision on early repurchase arising from misuse of set-asides was consistent with Fund practice and the way in which those amounts had been set aside, namely, the amount of access available for set-asides would have normally been available to the member even in the absence of debt-reduction operations.

Mr. Dawson observed that because of the possibility of substantial front-loading of set-asides under an extended Fund arrangement, he had suggested modifying the decision to allow the accelerated early repurchase of those set-aside amounts that had been accelerated by more than one year.

The General Counsel remarked that it might be helpful to recall other possible actions that could be taken by the Fund in the event of the subsequent derailment of a program or misuse of the Fund's resources. The question of the misuse of Fund resources normally should not arise, because members represent that a purchase would be used in a manner consistent with the Fund's purposes, and because the Fund usually did not specify a particular purpose for which the resources should be used. In effect, with one major exception in the past, the proposed decision

represented the first time that the Fund would identify the purpose for which its resources had been provided.

The provision in Article V, Section 5 of the Articles of Agreement relating to misuse had never been applied because it was extremely cumbersome both in substance and in procedure, the General Counsel continued. Procedurally, it required a report by the Fund to the member setting forth the Fund's views and prescribing a time for reply. The Fund could then limit the use of its resources by the member and eventually could declare the member ineligible. That was one of the few instances where a member could be declared ineligible without a breach of obligation; instead, misuse was a sufficient ground for a declaration of ineligibility. Thus, the establishment of an obligation should be considered with extreme caution.

With respect to substance, unless the Fund specifically identified the purpose for which its resources could be used, it was difficult to reach a finding of misuse, the General Counsel observed. In the event, a determination would have to be made in the light of circumstances. In instances where the purpose had been identified, however, misuse would be more easily identified. The burden of proof for the Fund would be alleviated because the failure of the members to use the resources in accordance with the specified purpose would be prima facie evidence of a use contrary to the purposes of the Fund.

The procedure with respect to misuse was cumbersome and time-consuming, and in the meantime, nothing happened--the member would continue to use the Fund's resources, the General Counsel commented. Therefore, in the past--for example, when the question of misreporting or noncomplying purchases had been discussed in the Board--a simpler procedure had been adopted, based on more clearly identifiable facts, namely, that a member had misreported the performance criteria on the basis of which the resources had been released by the Fund.

For the same reason, and because misuse could be easily identified, the cumbersome procedure of limiting the use of the Fund's resources or declaring the member's ineligibility was not needed, the General Counsel remarked. Instead, the staff had proposed an accelerated procedure that had the advantage of allowing the Fund to suspend purchases under the existing stand-by or extended arrangement. In contrast, if the time-consuming procedures under Article V, Section 5 were followed, the arrangement probably would run its course before the procedures had been completed.

The proposed decision had been limited to augmented amounts because Directors had indicated that those amounts were not viewed as a "normal use" of Fund resources, the General Counsel recalled. The staff understood that it was the Board's intention to apply the procedure only to those additional resources. In that event, Article V, Section 5 could be used as a general remedy for the misuse of accelerated set-asides, notwithstanding the somewhat cumbersome nature of that procedure.

In the event of the derailment of a program, a member would not be able to make further purchases under the existing stand-by or extended arrangement, the General Counsel continued. The question was whether an early repurchase expectation should also arise. The staff's proposal reflected the instructions that had been received from the Executive Board, namely, that because the Fund had taken an additional risk by accelerating the disbursement of its resources, they should be safeguarded by the introduction of a special provision. In the staff's view, an early repurchase expectation would not be justified for set-asides that had been disbursed according to the original schedule.

With respect to the flexibility of the proposed procedures, he had already explained the staff's intention to provide for more flexibility than would exist under a repurchase obligation or the procedure under Article V, Section 5, the General Counsel remarked. It was, of course, *for the Executive Board to decide whether to create an expectation or an obligation.*

The Chairman observed that the staff considered that the proposed decision represented a workable compromise in the light of the various views of members of the Board. He wondered whether there was room for further amendment in order to facilitate the unanimous adoption of the decision.

Mr. Evans remarked that he was not attracted to Mr. Dawson's suggestion to confine Part B to set-asides that were accelerated by more than 12 months. While that approach would focus on those cases with the maximum set-asides, it would also raise the most problems. In the event, not only would the program have gone off track, but the member would also be denied further purchases. In instances where the acceleration was less than 12 months, requiring an early repurchase could make it extremely difficult for the member to get the program back on track, and that would, in his view, be a punitive approach.

Mr. Enoch observed that Mr. Dawson's suggestion implied the acceleration of set-asides for more than 12 months, but to date, only acceleration up to 12 months had been approved by the Board. A proposal that assumed a further degree of acceleration would cause him some concern.

The staff's comments with regard to the fungibility of set-aside amounts were somewhat surprising, Mr. Enoch remarked. In his view, if a certain amount of resources was set aside for a debt-reduction operation which did not take place, the member would have additional resources at its disposal that could, for instance, be put into reserves and thereby satisfy the performance criteria in the next review. If, however, those resources were used for the intended purpose, the member would not have met the program targets and further disbursements by the Fund would cease. Thus, there must be a presumption that if the resources were not used as expected, the program should be re-examined and recast, particularly with respect to financing. That approach was not necessarily to the member's

disadvantage. But to argue that notionally, the overall use of Fund resources would have been the same, and that therefore no further action was needed, seemed questionable. Moreover, he understood that a number of Directors preferred a decision to establish an expectation of early repurchases only where the set-aside or the additional resources were not used as envisaged at the time of the Board's approval rather than in instances where a program subsequently went off track.

The Deputy Director of the Exchange and Trade Relations Department observed that arrangements for Mexico and the Philippines had both been approved in May-June 1989 and that the Board would soon receive requests from both countries for the acceleration of set-asides through the end of 1990, namely, for an acceleration spanning at least two annual program segments. While such an acceleration was not specified in the guidelines, the staff's understanding of the Board's earlier discussions was that front-loading and acceleration should occur within annual program segments rather than over the entire period of an extended arrangement. As negotiations in the initial cases proceeded, however, it had become clear that requests for substantially greater acceleration were likely.

Mr. Fogelholm remarked that he agreed with the thrust of Mr. Enoch's remarks. In his view, it should be easy to reach a consensus on the need to repurchase set-aside amounts that were not used as specified and where the program remained on track. An addition to Part A, paragraph 2, to that effect would assure symmetrical treatment of augmented and set-aside amounts in the event of misuse. He proposed that paragraph 2 be amended to read: "If the member, having purchased such set-aside amounts or additional resources, by the end of...."

Mr. Hubloue asked whether the proposed amendment meant that once repurchased, the set-aside resources would be phased in during the remainder of the program so long as the program remained on track.

Mr. García proposed a brief recess in order to draft a compromise text that would allay Directors' various concerns.

The Executive Directors resumed their discussion after a 15-minute recess.

The Chairman asked whether Directors could approve Part A, paragraphs 1 through 3, of the draft decision.

Mr. Grosche recalled that he had suggested some strengthening of the language in paragraph 2 to create a larger presumption that repurchases would actually be made, but he would reserve his position until he had heard the suggested revisions to paragraphs 2 and 3.

Mr. García stated that with respect to paragraph 3, he had indicated that a 30-day period would be too short; he proposed that the Managing Director should recommend in his report a flexible period of time, in light of the particular circumstances of the country.

The Chairman observed that the meaning of "a flexible period of time" was not clear. It might be possible to have a longer, but fixed period, with provision for some flexibility if management found that flexibility was warranted.

Mr. Al-Jasser commented that paragraph 3 already provided for such flexibility when it stated "within 30 days...or within such longer period as the Executive Board may specify."

Mr. Dawson remarked that he could agree that the Managing Director should recommend the appropriate period in the light of the member's particular circumstances.

Mr. Enoch asked whether the proposed 30-day period derived from other Board decisions where there was a presumption of an early repurchase.

The Deputy Director of the Exchange and Trade Relations Department remarked that a 30-day period was provided for in the decision on noncomplying purchases.

The General Counsel stated that 30 days was the period usually used, or such longer period as the Board may prescribe.

Mr. García remarked that if it was agreed that paragraph 3 would be subject to some flexibility, he could support it as it stood.

Mr. Grosche said that he could support a 40- or 50-day period without a discretionary provision.

The Chairman remarked that he would prefer provision for some flexibility rather than for a longer, but fixed, time period. He noted that a majority of Directors had accepted Part A, but that Mr. Grosche had reserved his position with respect to paragraph 3. He then invited comments on Part B, paragraphs 4 through 6.

Mr. García proposed that paragraph 4(a) be amended to read: "If the program of a member that has previously made accelerated purchases of amounts set aside beyond twelve months..." in order to support Mr. Dawson's view that Part B should apply only in cases where the acceleration had been for more than a year. Moreover, special consideration should be given if the program went off track because of factors beyond the control of the authorities. He therefore proposed the addition of a new paragraph, 4(c), indicating that the Executive Board "will give special consideration in those cases where the program has gone off track due to factors beyond the control of the authorities." Finally, the 30-day period provided in paragraph 6 was too short.

The General Counsel remarked that the proposed addition might be more appropriate at the end of paragraph 6.

Mr. Kabbaj said that he agreed with Mr. García's proposals. With respect to the 90-day period for bringing the program back on track, he agreed with those Directors who viewed that period as too short. Moreover, the Managing Director was required to report on the matter to the Executive Board promptly after the expiration of the 90-day period. He therefore proposed either to extend the period beyond 90 days or to give the Managing Director some flexibility with respect to the 90-day period.

The Chairman observed that "promptly" did not mean immediately, but in the usual expeditious manner, which allowed for some flexibility.

Mr. Hogeweg remarked that there was a good deal of flexibility in the text as it stood. For example, paragraph 5 stated that management "shall recommend...an early repurchase...or such other action as may be appropriate." That provision should be sufficient to cover instances where a program went off track for reasons beyond the authorities' control. Similarly, with respect to the 30-day period in paragraph 6, it was already explicitly stated that a longer period may apply "as the Board may specify." He was therefore hesitant to go along with explicit statements on how such flexibility was to be exercised.

The Deputy Director of the Exchange and Trade Relations Department observed that the Managing Director was to report to the Board at the end of the 90-day period. There was flexibility built into that provision. For example, if negotiations were about to be completed to get the program back on track, management's recommendation may be to delay further action for another 30 days.

Mr. Toé said that he agreed with Mr. Kabbaj regarding the 90-day period. When taken in conjunction with paragraph 6(b), namely, that "a member shall not be expected to repurchase pursuant to subparagraph (a) above if its program is back on track within the period specified in that paragraph," the member would still be obliged to make the repurchase even if the program was back on track in 120 or 150 days. The period specified in paragraph 4(a) was therefore important and should be extended to 150 or 180 days.

The Chairman observed that the length of the period set out in paragraph 4(a) was indeed a matter of judgment. With respect to Mr. García's proposals, the addition of a paragraph regarding cases where programs went off track owing to factors beyond the control of the authorities was fair and would improve the text. He therefore suggested that the Board should adopt that proposal. With respect to the 90-day and 30-day periods, he shared the view of Mr. Hogeweg, namely, that the proposed text already incorporated sufficient flexibility. When a program went off track there was urgent need for the member to take appropriate measures without delay to redress the situation. He therefore suggested to retain the text as it stood, noting that management had a certain flexibility with respect to informing the Board "promptly."

Mr. García said that he could accept the Chairman's proposal.

Mr. Kabbaj remarked that while in principle, 90 days might be sufficient, in practice, the 90-day period was computed from the date at which the purchase would have been available to the country, if the program had not gone off track. A staff review to determine nonperformance might occur only after the purchase, so that the member would not in fact have 90 days in which to bring the program back on track.

The Chairman stated that if a program went off track for reasons that were under the authorities' control, the Fund should not allow 90 days for the authorities to react. Rather, the authorities had to react instantaneously under the stand-by or extended arrangement. A period of 90 days should be sufficient for the authorities to take the necessary measures, especially if the time required for management to report to the Board as well as the 30-day period following the Board's decision were taken into account.

Mr. Toé remarked that he had no doubt that management would exercise flexibility as appropriate. He would, however, prefer to introduce some flexibility in paragraph 4 to reflect the statement in the staff paper that if negotiations with the member on appropriate corrective policies and measures were well advanced, the Managing Director may recommend a short extension of the 90-day period.

The Chairman commented that an explicit reference to such flexibility was unnecessary because in practice, when management was involved in intense and serious discussions with a country, the Executive Board had allowed management more time to finalize the negotiations.

Mr. Enoch said that he could go along with the Chairman's responses to the second and third points of Mr. García. On the first point--inserting the words "beyond 12 months" in paragraph 4--he would not wish to deprive management of flexibility with respect to accelerated purchases of less than 12 months. Moreover, he continued to hold the view that it was dangerous to include an explicit reference to the possibility of an acceleration beyond 12 months in the decision because no accelerations beyond 12 months had been considered by the Board so far.

Mr. Grosche remarked that he associated himself with Mr. Enoch's views. In that respect, his future position on all accelerations would be even more cautious.

Mr. Dawson stated that his authorities preferred a reference to accelerated purchases beyond 12 months, if not in paragraph 4, then in paragraph 6. He agreed with the thrust of the discussion on the 90-day period; the proposed text as written had enough flexibility. In paragraph 5, he observed that there was a presumption that the Managing Director would recommend an early repurchase. He would prefer instead, "shall recommend such action as may be appropriate," because paragraph 6 dealt with the specific option of accelerated repurchase. The reference to such action as may be appropriate clearly encompassed both the

possibility of an accelerated ordinary early repurchase or whatever other action may be required. With respect to the 30-day period, he would prefer to give management the authority to make a positive recommendation, on a case-by-case basis, regarding the appropriate period to effect a repurchase. Thirty days was certainly appropriate in the event of misuse of augmented resources in Part A, but the case for set-aside amounts was not as clear cut. He would therefore prefer to eliminate the presumption that 30 days was the norm in favor of somewhat more flexibility, namely, "within such period as the Executive Board may specify."

Mr. García said that he fully supported Mr. Dawson's proposal.

Mr. Hogeweg commented that he preferred the original text, where there was a presumption of a certain specified period. The same held for Mr. Dawson's suggestion with respect to paragraph 5, which would remove the presumption of early repurchase. Early repurchase was the subject of the entire decision and such deletion would be regrettable.

Mr. Fogelholm remarked that with respect to the 30-day period, the original text provided sufficient flexibility. He was concerned that Mr. Dawson's proposal would require a Board meeting to specify the period for repurchase, which was unnecessary with a specified period of 30 days.

The Chairman asked whether there could be a presumption of a period of about 30 days, with management having flexibility to extend or reduce that period in the light of circumstances.

The General Counsel remarked that usually it was the prerogative of the Executive Board to prescribe the period. The decision might provide for "within 30 days unless the Managing Director requests the Executive Board to adopt a longer period," for example.

Mr. Kyriazidis suggested that paragraph 5 be amended to take account of Mr. Dawson's proposal, namely, "the Managing Director shall recommend such action as may be appropriate, including that the member is expected to make an early repurchase of the set-aside amount."

Mr. Evans remarked that as Mr. Dawson had correctly noted, the expectation of early repurchase was raised in both paragraphs 5 and 6. A slight rewording of paragraph 6 to link it to paragraph 5 would allow the deletion in paragraph 5 that had been suggested by Mr. Dawson. For example, paragraph 6 could be linked to paragraph 5 with the introductory phrase, "Should the Fund decide that the member shall be expected to repurchase...."

Mr. Kyriazidis said that Mr. Evans's suggestion was acceptable to him.

Mr. Enoch remarked that he agreed with Mr. Hogeweg and Mr. Fogelholm and could support Mr. Evans's proposal.

Mr. Dawson stated that he could not accept Part B without a mention of accelerated purchases "beyond 12 months."

The Chairman observed that the issue of the acceleration of set-asides beyond 12 months could be considered on the occasion of the review of experience with the guidelines on Fund involvement in the debt strategy.

Mr. Dawson remarked that as the possibility existed for an acceleration of set-asides beyond 12-months, it would be unfair to expect for some countries to repurchase all accelerated purchases. Only that portion of the set-asides that was accelerated beyond 12 months--the extraordinary acceleration, compared with the set-aside amounts contemplated early in the debt strategy--should be subject to repurchase.

Mr. García stated that he fully agreed with Mr. Dawson regarding the 12-month period. The guidelines anticipated the possibility of an acceleration for the period of the arrangement, and for that reason, he would not delete the reference to accelerated purchases beyond 12 months.

Mr. Fogelholm remarked that Mr. Dawson's proposal could be counter-productive in that the exclusion of accelerated purchases of less than 12 months would only increase the Board's resistance to approve the acceleration of set-asides. It would be more appropriate to consider that issue as part of the review of the guidelines.

Mr. Enoch stated that Mr. Fogelholm's point was valid. A number of Directors' authorities were already concerned about accelerated set-asides of less than 12 months, but they were prepared to go along with such acceleration in the expectation that a decision such as that proposed by the staff would be put in place--namely, that if certain conditions were not met, there would be an early repayment of set-aside amounts. If that expectation was removed, it could become more difficult for the Board to approve any acceleration at all.

Mr. Grosche remarked that he shared Mr. Enoch's view. He could go along with 12 months, but he would be reluctant to agree to any further acceleration of set-asides.

Mr. Bindley-Taylor stated that his chair was opposed to Part B in any form. However, in the spirit of compromise, he could go along with Mr. Dawson's suggestion on paragraph 5, and he could understand the rationale for 30 days in paragraph 6(a). He also favored the inclusion of a reference to beyond 12 months in paragraph 4. The Fund's resources should be protected, but once they were released in support of a program, the Fund accepted the risk.

Mr. Toé said that while he had earlier opposed Part B, he was prepared to go along with the compromise proposed by Mr. Dawson that, in principle, repurchase would be limited to the amounts accelerated beyond 12 months.

Mr. Hubloue remarked that he agreed with Mr. Fogelholm on the set-asides subject to repurchase. The point of the Fund's guidelines was to support debt-reduction operations at an early stage. That would in most, if not all, cases require an acceleration of disbursements. It was necessary to protect those accelerated disbursements as much as possible, and Mr. Dawson's approach would complicate that effort.

Mr. Lombardo said that he could go along with Mr. Dawson's proposal.

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

APPROVED: August 16, 1990

LEO VAN HOUTVEN
Secretary

