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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 88/174

10:00 a.m., December 7, 1988

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

Executive Directors

M. R. Ghasimi

B. Jalan

Y. A. Nimatallah

J. Ovi

H. Ploix

G. A. Posthumus

K. Yamazaki

Alternate Executive Directors

C. Enoch

Zhang Z.

C. S. Warner

J. Prader

L. B. Monyake

R. J. Lombardo

M. A. Fernández Ordóñez

M. B. Chatah, Temporary

O. Kabbaj

B. Goos

E. Kiriwat

Hon C.-W., Temporary

L. E. N. Fernando

D. McCormack

A. R. Ismael, Temporary

I. A. Al-Assaf

M. Fogelholm

D. Marcel

G. P. J. Hogeweg

C.-Y. Lim

N. Kyriazidis

C. Brachet, Acting Secretary  
M. J. Miller, Assistant

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Also Present

African Department: G. E. Gondwe, Deputy Director; J. J. Jiménez.  
Exchange and Trade Relations Department: H. B. Junz, Deputy Director.  
External Relations Department: P. E. Gleason. Legal Department:  
F. P. Gianviti, General Counsel; W. E. Holder, Deputy General Counsel;  
R. H. Munzberg, Deputy General Counsel. Middle Eastern Department:  
M. Zavadjil. Treasurer's Department: F. G. Laske, Treasurer; T. Leddy,  
Deputy Treasurer; D. Williams, Deputy Treasurer; R. B. Hicks,  
B. E. Keuppens, J. A. McLaughlin, G. Wittich. Office of the Managing  
Director: R. Noë, Internal Auditor. Personal Assistant to the Managing  
Director: H. G. O. Simpson. Advisors to Executive Directors: N. Adachi,  
M. Al-Jasser, P. E. Archibong, M. Eran, S. M. Hassan, P. D. Péroz,  
D. C. Templeman, A. Vasudevan. Assistants to Executive Directors:  
S. Appetiti, H. S. Binay, S. K. Fayyad, B. R. Fuleihan, J. Gold,  
J. Heywood, J. M. Jones, P. Kapetanović, K.-H. Kleine, C. Y. Legg,  
V. K. Malhotra, R. Marino, T. Morita, M. Piantini, A. Rieffel, S. Rouai,  
M. J. Shaffrey, Yang J.

1. REPORT BY MANAGING DIRECTOR

The Chairman reported that he had attended the meeting of trade ministers on a midterm review of developments in the Uruguay Round of multilateral trade negotiations of the General Agreement on Tariffs and Trade in Montreal, Canada, along with the President of the World Bank. Following contacts with the press in the context of that gathering, it had been reported that he was not in favor of an early meeting of the Group of Seven. What he had stated had been reported inaccurately. His actual remarks were that it would not be wise to create a crisis by anticipating a crisis meeting of the Group of Seven, and that there was merit in conducting business as usual.

Occasional Paper No. 63, "Issues and Developments in International Trade Policy," had been made available to the ministerial meeting, the Chairman continued, and had apparently been useful to the participants. It was difficult to assess the degree of progress in those meetings, but his view was that despite the uncompromising positions of many of the negotiators, all had shown a strong desire to reach agreements. Final positions, however, often were being reserved pending the elaboration of final positions by others. It appeared that agreement could be within reach on tropical products, on strengthening the framework of the General Agreement on Tariffs and Trade, and on a mandate for the Director General of the General Agreement on Tariffs and Trade to explore ways in which cooperation between the Secretariat of the CONTRACTING PARTIES to the General Agreement on Tariffs and Trade and the Bretton Woods institutions could be made more effective. Agreements with respect to services and agricultural products were less likely. He remained optimistic about the meeting's final outcome, but believed that if there were to be concrete agreements, they would not be reached until the very end of the meeting.

2. INCOME POSITION - PRINCIPLES OF BURDEN SHARING - REVIEW OF IMPLEMENTATION

The Executive Directors considered the staff paper reviewing the implementation of the principles of burden sharing (EBS/88/219, 10/26/88). They also had before them a statement by the Treasurer on the midyear review of the Fund's income position for financial year 1989, which was scheduled for discussion on December 12, 1988 (see EBM/88/178).

The Treasurer noted that his statement contained information updating that in EBS/88/239 on the midyear review of the Fund's income position. In particular, the rate of interest on the SDR as of the preceding Friday was 7.38 percent, thus significantly higher than the rate which had been assumed in EBS/88/239. With respect to overdues, two Fund members had recently made payments; one of those members had now fully discharged its overdue financial obligations. In consequence, the amount of deferred charges that could not be offset by symmetrical adjustments to the rate of charge and the rate of remuneration in the third and fourth quarters of the current financial year would be smaller than had been assumed in

EBS/88/219 on the implementation of the principles of burden sharing. Finally, the total amount of overdue financial obligations had risen to almost SDR 2.6 billion as of December 1, 1988, of which approximately SDR 2 billion constituted overdue repurchases.

Mrs. Ploix made the following statement:

We would have preferred to discuss both burden sharing and the Fund's income position at the same time; the recent statement by the Treasurer on the Fund's income position makes it clear that the two subjects are closely related.

We are very concerned by the steady erosion of the concessional element of the rate of charge and its present level. The Treasurer's statement on the Fund's income position is worrisome in this regard, since it is now envisaged to set this rate at about 7.5 percent because of the recent rise in the SDR interest rate.

It is clear that the erosion of the concessionality in the rate of charge, among other factors, has contributed to decreasing the attractiveness of using the Fund's resources, and has discouraged countries from seeking the Fund's support when problems are at an early stage. As Mr. Reddy rightly pointed out during our last debate on burden sharing (EBM/88/118, 7/29/88), one can fear that this trend will continue, and even worsen in years to come, as a result of the significant decline in the net amount of Fund credit, which implies that the various costs will have to be spread over a smaller volume of Fund credit. We should keep this problem in mind during our discussion today.

This chair is strongly in favor of sharing equitably the cost of arrears among all Fund members, which is fully consistent with the cooperative character of the Fund. Indeed, it would be paradoxical and unfair for the countries which discharge their obligations to the Fund in a timely manner to assume an excessively large share of the burden. Furthermore, we strongly believe that burden sharing is fully in keeping with the cooperative strategy approved at the last Interim Committee meeting; my authorities are clearly of the opinion that both are closely related.

If the responsibility for arrears is borne by all members, the general awareness of this problem will be increased, and as a result all of us will be encouraged to find appropriate ways to solve it. It would therefore be wrong to consider burden sharing as a sign of the Fund's preparedness to accept the continuation of arrears, when, on the contrary, it is aimed at increasing the membership's responsibility for them.

In light of these considerations, I will touch briefly upon the specific topics proposed for discussion.

It is clear that the floor for the remuneration coefficient of 85 percent will not affect the implementation of burden sharing in the second quarter of the current financial year. Furthermore, the latest figures available suggest that the floor will not lead to a significant shortfall in net income by the end of the financial year. I note in passing that the discrepancy between the latest figures and those included in the staff paper clearly shows how difficult it is to make very precise estimates in this area. This chair considers that we should not hesitate to lower the floor if necessary, in order to preserve full symmetry between debtors and creditors. However, I can sympathize with those who fear that such a decision could be interpreted by the international financial community as a sign of our increasing difficulty in dealing with the arrears problem. In this context, given that there is no urgency, it may appear advisable not to put an unnecessary strain on the existing consensus. However, I would like to stress that we should be ready to take appropriate action within a reasonable time frame in order to avoid having to make a decision under pressure. It would be advisable to signal today our preparedness to go in this direction at a later stage, if necessary, in order to preserve full symmetry in the adjustment of both the rate of charge and the rate of remuneration.

I have already expressed our position on various occasions with regard to the Special Contingent Account. This chair has never been enthusiastic about the Account; indeed, this chair considers that it looks like provisioning, and therefore may give the impression that the Fund is prepared to accept losses or reschedulings. We continue to think that the advantages of this Account, i.e., greater flexibility and easier refundability, are not decisive, and we have never been very convinced by the staff's arguments in that regard.

My authorities agreed to join the consensus on the Special Contingent Account in a spirit of compromise, but they are not at all prepared to envisage any further additions to it beyond the 5 percent target already decided. Indeed, it would be somewhat inconsistent to accrue further precautionary balances and make the rate of charge more dissuasive, while beginning implementing our cooperative strategy with a view to alleviating the arrears problem.

I strongly favor maximum flexibility with respect to possible reductions in the Special Contingent Account, in accordance with our decision of last January. Therefore, I do not

think it is appropriate to establish criteria or indicators to determine when the Board might consider the reduction or dissolution of the Account.

Extending her remarks, Mrs. Ploix stated that her chair was in favor of a symmetrical sharing of the burden between debtor and creditor members of the Fund. Furthermore, her chair was in favor of the cooperative approach, and in that regard did not wish the floor for the remuneration coefficient of 85 percent to be considered in any circumstances as an impediment to the implementation of burden sharing. Although her authorities did not intend to request a lowering of the floor for the remuneration coefficient at present, they wished other Directors to prepare themselves, little by little, to move in the direction of such a lowering if that became necessary; of course, she, along with many of her colleagues, hoped that such a lowering would never be necessary. Her authorities were also extremely concerned that the rate of charge should be concessional, a fact that needed to be borne in mind in any discussion of burden sharing. Compared with the rate of charge which had obtained several years previously, the Fund's current rate was no longer concessional, in her view.

The Chairman said that he understood Mrs. Ploix's concern that the rate of charge should be concessional.

Mr. Nimatallah made the following statement:

This is a good opportunity to take a hard look at the principles of burden sharing, with a view to distributing the burden to all members, not just debtors and creditors.

Two facts should be borne in mind. First, in any financial institution, all shareholders are responsible for strengthening the institution's financial position in case of impairment in its income and/or assets. This is all the more important in a cooperative financial institution like the Fund. Second, any contribution made by members to alleviate the burden on the Fund should be refundable once the problem is resolved.

In that regard, two things are needed: first, the amendment of Section I of Executive Board Decision No. 8861-(88/67) on the principles of burden sharing; and second, the development of a mechanism in that decision so as to include in burden sharing those members who are not currently contributing under the present debtor-creditor symmetrical arrangement. A possible example of such an amendment in Section I of that decision follows:

1. The financial consequences for the Fund which stem from the existence of overdue financial obligations shall be shared among all member countries.

2. This sharing shall be distributed fairly and equitably in the following ways:

(a) in a simultaneous and symmetrical fashion between debtor and creditor members; and

(b) nondebtor and noncreditor members will contribute in a comparable fashion through a separate mechanism.

Billing currently noncontributing members a specific amount each quarter would be a way of reaching those members. This amount could be determined as equivalent to, say, an average of contributions made by debtors and creditors. A range of averages between contributors of large amounts and those of small amounts could also be developed. Whether a noncontributing member would be billed for an amount closer to the higher or the lower limit of the range could be decided, inter alia, in the light of its quota, as a background indicator. I am not certain that equity should be an overriding factor within each group, since it is already clear that equity does not exactly prevail at present within the creditor and debtor groups. The important point is that all members contribute in one way or another, and I am sure that the staff will be able to devise a workable mechanism to that end.

Turning to the immediate issues, it appears that dealing with arrears in the third quarter will be manageable under present circumstances, particularly if some countries settle their arrears to the Fund. There are some indications that the shortfall at the end of the financial year will be close to that realized in the last financial year, which was dealt with in the following financial year. That suggests that the same approach could be repeated without a need to lower the 85 percent floor for the remuneration coefficient.

I would like to propose for the Board's consideration a more flexible approach to the remuneration coefficient. For example, the Board could consider the remuneration coefficient of 85 percent not only as a floor, but also as a ceiling, for as long as the burden-sharing decision is in effect. By considering 85 percent as a ceiling, remuneration would be paid out at that level, even if an amount is available for disbursement above that level. Surplus amounts would be accumulated in a separate account, to be applied in quarters in which there is a shortfall. This will introduce flexibility, and will obviate the need for the Board to address the problem of how to deal with the situation when the remuneration coefficient touches--or falls below--the floor in any quarter. We can return to this matter when the Board discusses the Fund's income position for financial year 1989.

My proposals are for the Board's preliminary consideration only. If Directors find them helpful, I hope that they will encourage the staff to include them, and other proposals, in a paper on this matter, to be discussed in April, when we return to this subject matter in the context of a possible extension of the burden-sharing decision, should the need for it still exist. I would like the staff to inform the Board whether or not these proposals are workable before the discussion proceeds further.

I can go along with the indicators mentioned by the staff to be used as background on the basis of which the Board could form a judgment as to whether the amount in the Special Contingent Account should be increased or decreased. I am not in favor of the dissolution of the Account, and I see no compelling reason to dissolve it even if balances reach zero. It is prudent to maintain this Account, in case circumstances arise in the future that warrant its reactivation.

It would be a good idea to include a review of precautionary balances in future annual reviews of the Fund's income position.

The problem of the burden sharing of overdue financial obligations could be greatly reduced if countries in arrears settled at least their overdue charges, as Sudan once did, for which the Board was extremely grateful. I therefore appeal again to those countries to help reduce the burden that is being imposed unfairly on other members.

The Treasurer stated that Mr. Nimatallah's proposal on the use of the remuneration coefficient as a ceiling as well as a floor implied that although the rate of remuneration would continue to be set at 100 percent of the SDR interest rate, remuneration would be paid to those members with remunerated reserve tranche positions at the level of 85 percent of the SDR interest rate. A balance equivalent to 15 percent of the SDR interest rate would therefore be set aside by the Fund in a suspense account or an escrow account to be used to offset deferred charges. There were two ways the amounts thus garnered might be used. The amount that was set aside might be only sufficient to cover the amount of deferred charges. In that case, the end result would be equivalent to the present system, in which the adjustments were made in a symmetrical fashion when the floor for the remuneration coefficient of 85 percent was just being touched. Another possibility was that the amount set aside in the account would be in excess of what was needed in a particular quarter to offset the amount of deferred charges in that quarter. The Fund would then have some funds available for subsequent quarters to meet deferred charges in those quarters. Over the year as a whole, there was a possibility that the amount equivalent to 15 percent of the SDR interest rate would be just enough to offset deferred charges; but there was also the possibility that that amount would be insufficient, in which case Mr. Nimatallah's proposal



still left the possibility that the Board would need to address the question of the floor for the remuneration coefficient. If excess amounts were accumulated in the account over the year, and were not needed in that year, he believed that those amounts would have to be distributed to those countries which had held remunerated reserve tranche positions in the Fund over the course of the financial year.

The proposal that had been put forward by Mr. Nimatallah would make it easier to offset deferred charges in individual quarters, and in particular, in those quarters in which deferred charges could not be fully offset by symmetrical adjustments to the rates of charge and of remuneration, the Treasurer observed. To that extent, some operational ease would be brought to the implementation of the burden-sharing mechanism. However, the possibility remained that the floor of 85 percent for the remuneration coefficient would be touched over the course of the entire financial year. If Mr. Nimatallah's proposal were to be made operational, the possibility of basing the system on a floor for the remuneration coefficient of 80 percent, which was mandated in the Articles of Agreement, should not be excluded, in his view. That, however, went beyond Mr. Nimatallah's proposal, and he was presenting it only because the 15 percent set-aside might not fully offset all of the deferred charges in a financial year.

The idea behind Mr. Nimatallah's second proposal for the design of a mechanism by which all Fund members would contribute to the burden of overdue obligations had been discussed before, the Treasurer recalled. For legal reasons, it was not possible to obligate member countries to contribute to burden sharing on any other basis than had been established in the present burden-sharing mechanisms. The mechanism that had been established in 1986 had been the result of a very carefully worked out compromise, taking into account a large number of conflicting considerations.

He could not give a definitive view as to whether a voluntary mechanism could be created that would ensure that all members contributed in one way or another--even, as Mr. Nimatallah had remarked, not necessarily fully equitably--to the sharing of the burden, the Treasurer went on. Such a voluntary mechanism would not necessarily ensure that all those who were called upon to contribute would do so, or would contribute what was expected. It was difficult right away to give a straightforward response to the question of whether the mechanisms Mr. Nimatallah had in mind could be made operational. His remarks should be considered as tentative and preliminary, because Mr. Nimatallah's two proposals had far-reaching implications for the Fund's financial operations which would need to be analyzed carefully.

Mr. Nimatallah commented that at the heart of his proposal to freeze temporarily the remuneration paid at 85 percent of the SDR interest rate was the desire to reduce the long and involved discussions the Board was forced to engage in whenever the floor for the remuneration coefficient was touched. If the set-aside of 15 percent of the SDR interest rate

turned out to be insufficient, the matter would have to be explored again in any case. His intention was to propose an interim solution that could be experimented with for a year or two. It had to be admitted that the mechanisms the Fund had designed to address the problem of arrears were a patchwork of expediciencies, and that the fundamental cure was the settlement of overdue obligations, or at the least, the payment of overdue charges. In any case, from what the Treasurer had said, he took it that his proposal with respect to the remuneration coefficient was indeed workable.

With respect to his second proposal that a mechanism be designed whereby those countries which were neither debtors nor creditors to the Fund could contribute to burden sharing, Mr. Nimatallah continued, the Treasurer had expressed the view that there were legal barriers to the implementation of any kind of mechanism that would require contributions from all members. He recognized that any such mechanism would have to be implemented on a voluntary basis, but that was entirely in keeping with the nature of the Fund as a cooperative institution. That being said, he would appreciate it if the staff could come up with the details of a mechanism that would support his proposal. The Board could then decide whether or not such a mechanism would be appropriate, and/or practicable.

The Chairman stated that the staff would look into those proposals. The Fund was a cooperative institution, and, as the Interim Committee had made clear at its last meeting, it was important that all members became involved in one way or another in the cooperative strategy to clear arrears to the Fund. The Fund had recently begun to build up experience concerning the formation of support groups for countries in arrears, and one of its key objectives was to marshal support from a broad range of members for each support group.

The question of the voluntarism of the contributions that might be forthcoming from a mechanism derived from Mr. Nimatallah's proposal was a key one, the Chairman continued. The General Counsel had made it clear that the Fund did not have the authority to impose taxes or other financial responsibilities upon members other than those specified in the Articles of Agreement, even for the most important purposes. Of course, the staff would pursue Mr. Nimatallah's proposal further, but it was important that the Fund be prudent in innovating in that area, and that it be assured that such innovations had no unexpected or undesirable consequences.

Mr. Warner made the following statement:

We welcome this opportunity to review the operation of the principles of burden sharing and considerations affecting the Special Contingent Account. My authorities believe that the Fund must be vigilant in safeguarding its financial position in order to continue playing a central role in the debt strategy, and to preserve the monetary character and revolving nature of Fund financing.

The Executive Board's burden-sharing decision in 1986 (Decision No. 8348-(86/122)) reflected acceptance of the principle that the costs of financing deferred charges should be borne broadly among the membership, because all members have a common stake in preserving a strong role for the Fund in the global economy. It also reflected a recognition that all members have a responsibility to help find a solution to the growing problem of arrears to the Fund. But this decision was also taken on a temporary basis, to provide the Fund with breathing space to adopt and put in place strong measures to tackle the growing arrears problem. In supporting this arrangement, my authorities assumed that all members would participate actively in cooperative efforts to eliminate arrears. The record of this cooperation and activity is, I think, not altogether clear, nor is the level of responsiveness what we had anticipated.

With these considerations in mind, the information provided in the staff paper--and the Treasurer's statement for next week's meeting on the midyear review of the Fund's income position--is not particularly reassuring. The papers point out that the Fund was unable to cover additions to the Special Contingent Account and deferred income in the first quarter of financial year 1989, and that it is unlikely to be able to do so in the third and fourth quarters. Thus, the Fund appears to be on course to repeat the disappointing results of financial year 1988, when it was unable fully to finance deferred income in the last quarter, or to meet the net income target for the year. Given the continued growth of arrears, my authorities consider it imperative that the net income target for financial year 1989 be met.

The staff raises the possibility of a reduction of the remuneration coefficient for the third quarter below 85 percent of the SDR interest rate in order to facilitate the achievement of the net income target. The Board will revisit this issue in its discussion next week of the midyear review of the Fund's income position. At this juncture, this chair strongly opposes lowering the floor for the remuneration coefficient below 85 percent. That floor is an essential element of the burden-sharing decision.

The information in the staff paper suggests that the future of burden sharing remains clouded. We would again urge the management and staff to look for financing alternatives that impose less of a burden on the largest creditor and debtor members of the Fund, and distribute the burden more equitably among the general membership. We support in principle the concept raised in earlier discussions which would facilitate obtaining contributions to burden sharing from nondebtor and

noncreditor members. Accordingly, we invite proposals from the staff for proceeding in this direction, including the possibility of voluntary contributions.

Meanwhile, the most important step that can be taken is to continue implementing in full the three-part strategy to eliminate overdue financial obligations that was endorsed by the Interim Committee in Berlin. In particular, under the rubric of intensified collaboration, we look forward to a major effort by debtor nations to formulate strong adjustment programs, and to broad participation in support groups formed to develop the financing arrangements needed to make these programs succeed. At the same time, we must ensure that new arrears do not emerge, and we must be prepared to consider remedial action when Fund members refuse to cooperate in efforts to eliminate their arrears.

The strategy we have adopted will not by itself achieve our commonly agreed objective. Vigorous implementation of the strategy, however, should produce concrete evidence that the problem of arrears is being managed more effectively. In the absence of such evidence, my authorities have serious doubts about the desirability and wisdom of continuing the burden sharing of nonaccrued income.

The Special Contingent Account represents an extremely important component of the Fund's efforts to address the problem of arrears. The Fund is a unique and cooperative institution, and should be accorded preferred creditor status. Consequently, the emergence of arrears to the Fund represents a grave threat, and reinforces the need for the Fund to maintain high financial standards. Other official and private creditors cannot be expected to look to the Fund to protect the quality of their assets unless the financial position of the Fund remains strong.

To bolster its financial integrity in the face of rising arrears, the World Bank has found it necessary to establish provisions against possible losses. The Fund, of course, does not borrow in private financial markets, but the Fund's shareholders merit no less consideration than do the private lenders to the World Bank. Moreover, as emphasized by a number of other Directors, the case for the Special Contingent Account goes beyond the problem of arrears. Rather, it should be seen as evidence of generally prudent financial management by the Fund.

The staff paper suggests that the adequacy of the Special Contingent Account could be reviewed once a year at the time of the annual review of the Fund's income position. The Board currently reviews the financial impact of the burden-sharing arrangements quarterly, if need be, and the Fund's income position at least twice a year. Both the burden-sharing

arrangements and the income position are affected by inherent uncertainties in projections relating to arrears. The adequacy of the Special Contingent Account is subject to the same uncertainties. Therefore, we believe that its adequacy should be reviewed not just once a year, but whenever appropriate, including on those occasions when burden sharing and the Fund's income position are reviewed.

The staff argues for a judgmental approach to the criteria for determining the adequacy of the Special Contingent Account and the possible dissolution of the Account. Given the pressing need to maintain a structured approach to address the arrears problem and protect the Fund's financial integrity, however, there is considerable merit in a quantitative approach to assessing the adequacy of that Account. This chair has in the past proposed that the Fund add to the Account a fixed percentage of the overdue repurchases (10-15 percent) exceeding a certain age (18-24 months). With or without such an approach, however, the fact remains that arrears are accumulating rapidly in relation to the Fund's precautionary balances. Consequently, my authorities believe that it is clearly premature to discuss the dissolution of the Special Contingent Account. We would, nevertheless, appreciate receiving regularly information on the financial ratios included in Table 2 of the Appendix to the staff paper. Among the different ratios provided, we attach the greatest significance to those relating overdues to the Fund's precautionary balances, and to credit outstanding to members in nonaccrual status. Also, we hope that the staff will continue to explore additional statistical measures of the Fund's financial position, and share the results of this work with the Board.

The United States strongly supports the three-part strategy adopted in Berlin to address arrears. All parts of that strategy must be implemented firmly to achieve the objective of eliminating arrears. The arrears problem has not been brought under control, as was expected when the burden-sharing arrangements were adopted. If this chair is to continue to support burden sharing with respect to deferred income, greater efforts will be needed by all members to tackle arrears and protect the Fund's financial position.

Mr. Prader made the following statement:

When the Board discussed the work program for the coming months on November 4 (EBM/88/163 and EBM/88/164), there was broad agreement on the procedural benefits of clustering closely related topics close together in time, both to avoid the need for repetitious, almost identical, statements, and to clarify the issues at stake and focus the Board's discussion of them.

We therefore regret that the Board will review the closely related issues of the implementation of the principles of burden sharing and of the Fund's income position in separate discussions nearly a week apart, instead of considering them together, and that another four days will pass before the review of overdue financial obligations to the Fund is undertaken. Some clarification of the reasons why the Board's expressed wish to have related topics grouped together was not taken into account would be appreciated.

As to the operation of the burden-sharing mechanisms during the first and second halves of financial year 1989, we share Mrs. Ploix's concerns about the decline of the concessionality in the rate of charge, and the implications of that for the attractiveness of the Fund's resources to borrowers. Nevertheless, we think we should stick to the established burden-sharing mechanisms at this stage. For the time being, we see no reason for lowering the floor for the remuneration coefficient below its present level of 85 percent. Such a lowering would be appropriate if the amount of deferred charges not covered on a symmetrical basis was displaying a rising trend, but it is not doing so, and this chair believes that so long as deferred charges can be financed on a symmetrical basis over time, the floor for the remuneration coefficient should be left untouched. For similar reasons, we favor carrying forward shortfalls to the subsequent quarter, particularly when the shortfalls are small. That this is now the case is confirmed by the most recent data cited in the Treasurer's statement. In fact, precisely as a result of our intensified collaborative approach and the recent payments by some members, we expect the situation to improve further, thus reducing further the need for adjustments.

On the issue of distributing the burden of overdue financial obligations to all members, although we agree that the emergence of sizable arrears harms not only debtors and creditors, but also the so-called neutral countries, we see at present neither any compelling need, nor much opportunity, to depart from established procedures. In any case, we would have to devote further discussion to Mr. Nimatallah's preliminary considerations.

Indeed, several arguments can be made in favor of the status quo. First, the analogy that is drawn about the responsibility of shareholders in any other financial institution and in the Fund is false; unlike the shareholders of other financial institutions, Fund members may pay charges, receive remuneration, or neither. Second, it was demonstrated in the Board's discussion of burden sharing on April 27 (EBM/88/66 and EBM/88/67) that the Articles do not provide the necessary latitude for imposing additional obligations on members. Third, the Board should not forget that the potential contribution from

the so-called neutral members can only be marginal, since taken as a group, they account for only a small fraction--approximately 7 percent--of total quotas. Besides, it seems to me unwise for the Board to jeopardize the burden-sharing compromise that it has managed to arrive at, difficult as it was to establish, and as fragile--but nonetheless necessary--as it is.

With respect to the criteria or indicators for reducing amounts in or dissolving the Special Contingent Account, the Account should indeed be only temporary, and I regret that I must disagree with Mr. Nimatallah on this point. This chair agreed to the establishment of the Account only because the refundability of the funds put into it was in prospect. The view of this chair is basically similar to that of the staff--that the judgmental approach that was used when additions to the Special Contingent Account were considered will be equally appropriate when consideration is given to reducing amounts in the Account or dissolving it. Such an approach does not exclude assessments based on some relevant indicators, like those suggested in the staff paper, but this chair could not accept a mechanistic formula which would establish any kind of trigger mechanism or direct quantitative link with the movements of those indicators. Because the seriousness of the arrears situation makes a high degree of automaticity inappropriate, we believe that the question of reductions of amounts in the Special Contingent Account, like the question of additions to it, will call for formal Board involvement. Additionally, to avoid conveying to the outside world that the Fund is mechanically linking changes in the Special Contingent Account to developments in the overdues situation, we think that judgments about the appropriate level of deposits in that Account, and revisions to it, should be made only in the context of the annual review of the Fund's income position.

Mr. Yamazaki stated that he welcomed the discharge of overdue obligations by Jamaica, and the partial settlement of its overdue obligations by Zaïre. Nevertheless, the level of outstanding overdue financial obligations to the Fund was increasing steadily, and constituted a serious concern in the context of the Fund's financial position. The level of arrears raised two questions. First, was the current level of the Fund's precautionary balances sufficient in the light of the present level of outstanding overdue obligations to the Fund; and second, on a flow basis, were the current burden-sharing mechanisms appropriate?

On the first question, his chair believed that there was a pressing need to build up substantially the Fund's precautionary balances, Mr. Yamazaki continued. On the second question, the current pace and the ad hoc approach to the accumulation of precautionary balances could be

considered inadequate in light of the large amount of arrears. Also, the Fund had faced difficulties many times in adjusting the necessary amounts through the current burden-sharing mechanisms.

In light of those considerations, Mr. Yamazaki went on, his chair believed that the time was ripe to consider a new scheme to protect the Fund's financial position from the long-term perspective. It was essential that the Fund make further placements to its precautionary balances in a framework which could redress the issue of overdue financial obligations to the Fund, as well as the Fund's financial risk. He urged the staff to review the proposal that had been made last summer by Japan in relation to the writing off of certain overdue obligations, and to explore possible measures that would make that proposal effective by the time of the Board's discussion of the matter next spring.

His chair believed that the issue of the floor for the remuneration coefficient should be discussed on the occasion of the midyear review of the Fund's income position, Mr. Yamazaki remarked. Without a comprehensive review of the current burden-sharing mechanisms, his chair remained reluctant to make partial adjustments to them.

He shared the view that had been expressed by Mr. Warner that discussion of a reduction of amounts in or dissolution of the Special Contingent Account was premature, given the increasing level of arrears to the Fund, Mr. Yamazaki concluded. However, he supported the use of the judgmental approach in that regard. In considering the adequacy of balances in the Account, the amount of precautionary balances as a whole needed to be taken into account, along with any relevant indicators, as the staff had suggested in the paper, because the matter of precautionary balances as a whole covered a broader financial risk. A great deal of weight should be given to the matter of arrears to the Fund at the time of the review, however.

Mr. Fernández Ordóñez made the following statement:

It is time to study some changes to the Special Contingent Account and the burden-sharing mechanisms. We now have enough experience to do so, and, most important of all, we have the important decision adopted by the Interim Committee since the last review.

This chair, along with many others, reluctantly accepted the mechanisms of burden sharing in the past, a position that was entirely justified by the urgency of the situation. The cooperative character of the Fund had been seriously affected by the behavior of countries in arrears--here I refer to the objective consequences of their behavior, and not to their willingness to remain current with the Fund. The Board reacted to that situation rapidly and prudently, but also, as we can see clearly now, noncooperatively. As if it were a private and noncooperative institution, the Fund established a precautionary



account--the Special Contingent Account--fed by the income of the institution, and burden-sharing mechanisms supported not by all members, but only by some.

The Interim Committee has now re-established the cooperative spirit of the institution, by adopting a collaborative strategy that everyone hopes will be successful. We should react in accordance with that strategy by making changes in mechanisms that were adopted in an emergency situation. The Special Contingent Account should be dissolved, and its funds employed to reduce the rate of charge to debtor countries--which makes even more sense at a time when market interest rates are increasing. An account should be created that is compatible with the Fund's cooperative character, that is, based on the contributions of all members. The same can be said about the burden-sharing mechanisms. The problem of arrears is a problem of all the member countries, and must therefore be supported by all members, and not only by debtors and creditors.

The obvious way to accomplish a more equitable burden sharing is by basing contributions on quotas; that is the usual way such a problem is solved in a cooperative. However, in reviewing the past discussions on this subject, I noted that the General Counsel said that the Fund could not oblige members to make contributions in addition to their quota--a point made again today by the Treasurer. That is understandable, but there is a logical principle here: if all members cannot be obliged to contribute to the burden, clearly only some of the members cannot be obliged to do so either. The Articles may prescribe that if it is intended that all members should bear an additional burden, a decision taken by all members is necessary; however, in no case do the Articles allow only part of the membership--including those that pay nothing, or very little in proportion to their quotas--to decide that others should carry the whole burden.

This chair reluctantly accepted the current burden-sharing mechanisms for the sake of urgency. But it is now time to design mechanisms in accordance with the Fund's cooperative character. I support the proposal put forth by Mr. Nimatallah for the design of a mechanism whereby all Fund members would contribute to burden sharing.

Mr. Enoch stated that, as the Treasurer's statement on the midyear review of the Fund's income position had confirmed, the burden-sharing arrangements had worked very satisfactorily over the previous six months. Moreover, even on the staff's fairly pessimistic assumption that none of the members currently overdue for six months would settle their obligations to the Fund in the foreseeable future, and that two additional

members would fall into nonaccrual status before the end of the financial year, it seemed clear that the current burden-sharing arrangements would not be severely strained over the following two quarters.

Over financial year 1989 as a whole, Mr. Enoch continued, the adjustments made possible under the current burden-sharing mechanisms, with the deferral into the next quarter of amounts of nonaccrued income that could not be compensated by a symmetrical adjustment of the rates of charge and of remuneration because of the floor for the remuneration coefficient of 85 percent, seemed likely to generate more than sufficient income to compensate for deferred charges in the financial year. While the current projections showed that up to SDR 3 million might have to be deferred into financial year 1990, that was a substantially smaller amount than had been carried forward into the present financial year from the last quarter of financial year 1988. Moreover, given the new intensified collaborative approach to the arrears strategy which the Board had carefully and painstakingly developed over the preceding few months, there were grounds for hoping that one or more members currently overdue would settle their obligations to the Fund within the following six months. Thus, the need to carry forward any deferred charges into financial year 1990 might be further reduced, or even eliminated altogether, thus wiping the slate clean for the new financial year. In the light of those considerations, and recalling the long and difficult negotiations that had been necessary to reach the fragile consensus behind the current burden-sharing arrangements, he saw no case for disturbing those arrangements at present.

Two points were of fundamental importance, Mr. Enoch remarked. First, it was essential that the Fund's financial integrity not be jeopardized by the continued accumulation of overdue obligations. Second, the burden of safeguarding that financial integrity should be shared equitably and symmetrically by debtor and creditor members in an agreed framework. The staff papers had shown that on current projections, both of those requirements would be met under the existing burden-sharing mechanisms. The present arrangements combined effectiveness with symmetry, and the floor for the remuneration coefficient of 85 percent permitted a smoothing of the burden of adjustment within the financial year. In that regard, he had been particularly interested in the refinement to the current arrangements that Mr. Nimatallah had proposed, under which the floor to the remuneration coefficient might be regarded also as a ceiling. While the prospect of having to defer charges to attain the net income target for the financial year remained, the possibility of using such a device to smooth fluctuations in the rate of charge between quarters within a financial year was worth exploring, given the interests of all members in ensuring that the fluctuations in the rates of charge and of remuneration were minimized. Of course, any move in that direction should preserve the symmetrical nature of burden sharing. If the rate of remuneration was set at 85 percent of the rate of interest on the SDR, in order to cover shortfalls in future quarters, the burden that was consequently borne by the creditors should continue also to be matched by the debtors.

He had also been interested by Mr. Nimatallah's idea that a mechanism should be created to extend burden sharing to those members that were not currently either creditors or debtors of the Fund, Mr. Enoch continued, even though he perceived a number of difficulties in implementing such a mechanism. For example, the question arose as to how contributions would be assessed, and how the payments would be levied. That notwithstanding, he also would be interested in the staff's further investigation of that proposal.

He fully endorsed the staff's recommendations concerning the Special Contingent Account, Mr. Enoch concluded. He understood the strong views that had been expressed on previous occasions by some Directors about the Account, but it would be difficult, and perhaps even unhelpful, for the Board to attempt to lay down rigid predetermined formulas to determine under what circumstances a reduction in the amounts in, or the dissolution of, the Account might be appropriate. The adequacy of the balances held in the Special Contingent Account could certainly be reviewed at the time of the review of the Fund's overall income position. The scope and breadth of such a review should depend upon factors that the Board judged to be relevant at that time.

The Treasurer stated that the staff would examine both proposals made by Mr. Nimatallah, to determine the repercussions on the Fund's operations. The mechanism Mr. Nimatallah had proposed to involve so-called neutral Fund members in burden sharing might supplement the current burden-sharing arrangements. A new mechanism could be added on a voluntary basis for those members which had neither a reserve tranche position in the Fund nor holdings of their respective currencies above 100 percent of quota in the Fund. Maintaining the current burden-sharing arrangement would assure that the offsetting of deferred charges actually occurred.

Mr. McCormack made the following statement:

In the view of my authorities, the burden-sharing mechanisms have operated in a relatively satisfactory manner in the first half of financial year 1989. However, it is clear that as the level of deferred charges rises in response to rising overdue obligations, it becomes increasingly difficult to maintain the present burden-sharing arrangement. If the 85 percent floor on the remuneration coefficient is to be maintained, it may not be possible to ensure that the deferred charges are borne equally by creditors and debtors through the symmetrical adjustment of the rates of remuneration and charge. However, the view of my authorities remains that there is no pressing or immediate need at present to change the floor on the remuneration coefficient.

In retrospect, the decision taken last May to defer charges that could not immediately be covered under burden sharing to a subsequent quarter proved to be reasonable. The staff paper presents projections that suggest that the amount to be burden

shared in the third quarter of financial year 1989 would exceed that which could be covered within the 85 percent floor on the remuneration coefficient. Furthermore, the projections indicated that the deferred charges from the third quarter could not be fully covered in the fourth quarter. In the event, as the Treasurer's statement for the midyear review of the Fund's income position indicates, those projections have been overtaken by events. New developments suggest that there will not be a problem in continuing with the present burden-sharing arrangement, at least in the immediate future. These developments also illustrate the large degree of uncertainty associated with these projections. I do not want to labor these issues further now, as the Board will be addressing them in detail on Monday, December 12, 1988. I might add that my authorities think that in the future, reviews of the operation of burden sharing should be held, whenever possible, in conjunction with the review of the Fund's income position, and I would echo Mr. Prader's comments on this point. I think it is extremely difficult and artificial for us to divide the discussion of those topics.

With respect to a reduction of amounts in or dissolution of the Special Contingent Account, a situation may arise in which it would be desirable to return some or all of the funds held in the Account prior to the complete discharge of all overdue obligations. Given the large number of factors which may enter into this decision, and the nonquantifiable nature of some of them, my authorities do not think it would be appropriate to establish a formula that operates in a mechanistic fashion. Consequently, we agree with the staff that a judgmental approach should be used when considering reductions in amounts held in the Special Contingent Account. My authorities would welcome an analysis of precautionary balances, including the Special Contingent Account, in future annual reviews of the Fund's income position.

We agree with the principle behind Mr. Nimatallah's suggestion that the burden-sharing arrangement be extended to members which are currently neither debtors nor creditors. As Mr. Nimatallah emphasizes, it is particularly appropriate in a cooperative institution that responsibility for the financial health of the institution be shared by the entire membership. We would be interested in having the staff explore this proposal further, and outline alternative modalities. Having said that, we wonder how effective such a necessarily voluntary scheme would be in practice, and whether the size of the resulting contributions would justify the work entailed. The Treasurer has said that the contribution would be supplementary, and has responded tentatively to the proposal; but I would welcome a fuller staff analysis in due course as to whether a workable and cost-effective formula can be devised.

My authorities think that Mr. Nimatallah's second suggestion that the remuneration coefficient of 85 percent be considered both as a floor, and as a ceiling--to accumulate a surplus so as to create a buffer against unfavorable developments--merits consideration. We wonder how such a scheme could be made to work in a way that would assure the continuation of parallel treatment of creditors and debtors, and the equitable sharing of the burden between them.

Mr. Hon stated that he welcomed the opportunity to review the implementation of the principles of burden sharing. Since the last review in April 1988, the deteriorating situation of overdue financial obligations to the Fund had largely been contained. Little progress, however, had been made toward the normalization of financial relations with members who had been in chronic arrears to the Fund. He welcomed the adoption by the Board, and the endorsement by the Interim Committee, of an intensified collaborative approach for the resolution of arrears. Many borrowing members, including several in his constituency, had been making tremendous efforts to remain current with the Fund, despite the unfavorable external environment and the many difficult domestic problems that they had had to contend with.

In the last review, Mr. Hon continued, his chair had reluctantly agreed to the compromise that the burden for the 5 percent addition to precautionary balances that was to be placed in the Special Contingent Account be shared equally between debtor and creditor members. However, the 5 percent income target for reserve accumulation had always been borne solely by the borrowing members. Therefore, in actuality, only 2 1/2 percent of the burden for the accumulation of reserves and the precautionary balances had been borne by the lending members, while the borrowing members had to carry a burden of 7 1/2 percent--which was about three times as large.

In light of the large anticipated shortfall in the Fund's income target projected from the first half of the current financial year, Mr. Hon went on, a substantial increase in the rate of charge appeared unavoidable. The borrowing members would thus be carrying a very large relative, as well as absolute, burden. While the staff had reported that deferred charges which could not be fully offset by the principles of burden sharing, with the floor for the remuneration coefficient remaining at 85 percent in the second half of the financial year, was likely to be insignificant, he would still like to urge the Board to give serious consideration to the suggestion that the floor for the rate of remuneration be lowered to 80 percent of the SDR interest rate, as stipulated in the Articles of Agreement. He fully supported Mrs. Ploix's suggestion that the Board signal its preparedness to go in that direction at a later stage, in order to preserve full symmetry in burden sharing.

He could go along with the staff's suggestion that the review of the Special Contingent Account, so as to determine the reduction of amounts in

or dissolution of the Account, be undertaken in the context of the regular annual review of the Fund's income position, Mr. Hon concluded. He also agreed that determining the adequacy and necessity of the Special Contingent Account was a highly complex and difficult topic. He therefore supported the suggestion that a judgmental approach be adopted, rather than the use of a mechanistic linkage to selected indicators, in such an assessment.

Mr. Lim made the following statement:

We welcome this opportunity to review the implementation of the decision on burden sharing. We all know that the current arrangements are the result of a compromise that was not easily achieved. These arrangements are far from perfect, but have proven themselves to be reasonably robust so far, and we would not want to tamper with the burden-sharing decision unnecessarily.

We are therefore inclined at this stage to continue to adhere to the current arrangements, involving symmetrical adjustments to the rates of charge and of remuneration, subject to the floor on the latter of 85 percent of the SDR interest rate. This will no doubt mean that, from time to time, we will again need to carry forward any income shortfall from one quarter to another.

This is clearly not a sustainable strategy for the longer term. Nevertheless, the carrying forward of any shortfall in net income from quarter to quarter within the financial year does not present us with major problems of principle, although we would feel somewhat less relaxed were we to have to carry forward once again such a shortfall from one financial year to another. Moreover, the amounts involved so far have been manageable, and the staff paper suggests that on current assumptions they are unlikely to be significantly larger in the future. Indeed, the Treasurer's latest statement on the Fund's income position suggests that the amounts involved for the third and fourth quarters of financial year 1989 may be as low as SDR 1-2 million. I presume this reflects, inter alia, recent increases in the SDR interest rate. I would be interested to know the staff's assumptions regarding the basic rates of charge and remuneration which underlie these revised projections.

The Board should also not forget that burden sharing merely addresses the symptoms of the arrears problem, rather than the underlying cause. In this regard, my authorities strongly endorse the Fund's continuing efforts to resolve the arrears problem, and we remain optimistic that these efforts will bear fruit sooner rather than later. We should bear in mind, therefore, that the staff's projections are based, quite sensibly, on the worst-case assumption.

It is relevant to note that the Treasurer's statement also mentioned a recent partial payment of overdue obligations by Zaire. This is encouraging news. I recall that at the Board's last review of Zaire's overdues (EBM/88/152 and EBM/88/153, 10/12/88), the Chairman anticipated making an informal verbal report to the Board on progress in the case of Zaire prior to the discussion on the midyear review of the Fund's income position. I look forward to that report, including any further details that can be provided on this partial repayment.

I was interested by Mr. Nimatallah's proposal to amend the burden-sharing decision to allow for a separate mechanism to ensure that members who are neither creditors nor debtors carry their fair share of the burden. We recognize and concur with the principle that burden sharing should be spread across the full membership. Were we to go down the path suggested, the most logical approach would probably be to base the burden-sharing arrangements on members' quotas. This issue has, however, been canvassed in the past. We understood that such an approach would raise significant difficulties with regard to the Articles of Agreement, which effectively limit the Fund's ability to impose such a cost on members who are neither debtors nor creditors.

Mr. Nimatallah's proposal for a separate billing mechanism would presumably confront the same difficulties. It would also effectively introduce a two-tier arrangement, with obvious associated inequities, particularly between noncreditor and nondebtor members and those who are relatively small debtors or creditors.

We are therefore inclined at this stage to adhere to the current burden-sharing arrangements. However, I would be very much interested in any further staff studies on Mr. Nimatallah's proposals.

Finally, on the issue of the Special Contingent Account, while recognizing that the current discussion is in fact a response to an earlier Board request, the staff paper tends to confirm our view that the existing guidance provided by the Board with regard to the eventual dissolution of the Account--namely, "...when there are no overdue charges and repurchases, or at such earlier time as the Fund may decide..."--remains adequate. My authorities strongly favor a judgmental approach to this issue, and to the broader question of the adequacy of the Fund's precautionary balances. The development of criteria to be applied in a mechanistic way does not seem to us to be a particularly useful approach. We see considerable merit in the staff proposal that the Special Contingent Account, and the

adequacy of precautionary balances more generally, be reviewed in the context of the regular review of the Fund's income position.

Mr. Ovi made the following statement:

When the issue of burden sharing was discussed in April 1988, the consensus was to continue the approach followed until then for a further period of one year. The review to be undertaken at midyear was to be made in light of steps taken with regard to the arrears question. Indeed, we are pleased to note that there have been some positive developments lately in this area, resulting in an improved outlook for deferred charges for the remainder of the current financial year, when compared with the staff's projections made in mid-October. Moreover, if we adopt an optimistic view--which I think we should--with regard to the outcome of the intensified collaborative approach on overdues, we might hope for a further amelioration of the situation on deferred charges in the months to come.

Thus, we do not see any compelling reason for challenging the present burden-sharing mechanisms. Indeed, we would caution against any attempt to tamper with what is already a delicate balance. The overriding concern must be not to embark on possible changes unless it seems almost certain that such changes will be very widely accepted.

With this in mind, I have difficulty with the proposals put forward by Mr. Nimatallah. While I can certainly share his concern--as expressed by other Directors as well--that the financial consequences of arrears should be shared by the entire membership, it seems that his suggestion will lead, at best, to only a slightly less unfair system than at present, while at the same time entailing serious risks. First, I suspect that his proposal will bring about only a marginal redistribution of the burden. Second, it will automatically introduce a new injustice, to the extent that some members not currently contributing to burden sharing could be billed considerably more than some other members which have only a small creditor or debtor position with the Fund at present. Once we begin down that route, we logically end in a burden-sharing system based on quotas. Third, as the Treasurer has reminded us, something of this nature can only be done on a purely voluntary basis, and I simply do not see the necessary consensus developing. I may add that recent experiences with negotiations for the enhanced structural adjustment facility and preliminary talks on support group contributions have not been reassuring in this regard. Thus, in order not to sacrifice the existing arrangements, any proposals would need to be entirely supplementary to the present system in any case. Finally, there is a simple trade-off



between costs and benefits. How would the staff go about negotiating such voluntary changes, without incurring substantial costs in terms of manpower, and, eventually, traveling? One might also add that the more we reform our present system, the more it takes on automatically a more permanent character, and I think we should continue to insist that the burden-sharing arrangement is a temporary arrangement only. Therefore, I would be quite reluctant to ask the staff to go very far in the direction of working on dramatic changes in our present system.

I would be equally hesitant about the proposal to make the remuneration coefficient of 85 percent a ceiling as well as a floor, so as to accumulate funds for later periods when substantial amounts of deferred charges may arise. Such a mechanism is not needed at present, and would send the wrong signal about the Fund's future arrears situation.

Having said that, this chair continues to take a pragmatic attitude as to the question of rolling-over deferred charges, as well as temporarily going below the 85 percent floor for the remuneration coefficient, as appropriate--that is, depending upon the actual circumstances.

In sum, rather than making formal changes in our present burden-sharing system, this chair should like to see the Board's efforts concentrated on finding solutions to individual arrears cases.

Like most Directors, I can endorse the staff's proposal to review the future of the Special Contingent Account in connection with the annual discussion of the Fund's income position. Decisions to augment or reduce the amount in the Account, or, in time, to dissolve the Account, should be taken entirely on an ad hoc basis, as before.

Mr. Nimatallah commented that he was not suggesting the introduction of any fundamental changes into the arrangements, but rather a supplementary mechanism.

Mr. Ovi remarked that if no fundamental changes were to be made, then the suggestions would not be of very much help, either, in his view.

The Chairman observed that Mr. Nimatallah's suggestion appeared to be in the nature of a compromise; although no significant changes would be introduced, the Board would be moving in the direction of improving the burden-sharing mechanisms.

Mr. Kyriazidis made the following statement:

The position of this chair has not changed since the last review of the decision on principles of burden sharing in April 1988. The justification for the burden-sharing mechanisms appears to have been somewhat strengthened by the most recent developments in the Fund's strategy in the area of overdue obligations.

According to the staff's projections, it appears likely that in the second quarter, both deferred charges--including those carried forward from the previous quarter--and additions to the Special Contingent Account can be financed, given the current floor to the remuneration coefficient. Under certain assumptions, however, fully covering the shortfall in the third and fourth quarters would not be possible if that floor were to be maintained. We are in favor of carrying forward a possible shortfall for the third quarter to the final quarter of financial year 1989, should this be necessary.

Any projection for the fourth quarter is at this time premature, and carries a high degree of uncertainty. In any case, should a shortfall occur, the floor for the rate of remuneration should be maintained at 85 percent of the SDR rate of interest. Consequently, the difference eventually not covered by the funds generated by symmetrical adjustment of the rates of charge and of remuneration should be raised by increasing the rate of charge alone. That position is justified because burden sharing is only part of a larger strategy to tackle the arrears problem, and it actually deals with only some of the consequences of arrears.

Several countries in arrears do not seem to be in a position to repay, unless they receive substantial financial support from donor and creditor countries. Recognizing the need for a more incisive intervention, the Board proposed the intensified collaborative approach. The support groups and the broad commitment some creditor countries are undertaking are all elements of this broader picture, and will require some creditor countries to bear an even heavier burden. Consistent with that, it is difficult to see a sufficient reason to keep augmenting the resources of the Special Contingent Account, unless it is believed that the overdue obligations will never be repaid. If that is the case, additions to the Account would appear to be very close to provisioning. We should reject that hypothesis.

If it is decided that the Special Contingent Account should be maintained to strengthen the Fund's financial position, then it should be strengthened with regard only to the more

protracted arrears--the duration of which is longer than, say, 12 months. The Fund has other reserves which should be taken into account in facing the arrears problem.

It is inappropriate to review separately the adequacy of the Special Contingent Account on the basis of indicators, or a system triggered automatically by indicators. The Account must be considered on the same footing as reserves, and the assessment of its adequacy should therefore be carried out together with the assessment of the adequacy of all other precautionary balances accumulated by the Fund. The assessment of the adequacy of the precautionary balances must be judgmental, since it relies on many factors, among which are the size of the Fund, its liquidity position, its hidden reserves, outstanding credits, the duration of overdue obligations, the progress of new approaches to clearing arrears, and the degree of cooperation between the debtors in arrears and the Fund.

The review of the adequacy of precautionary balances, including the reduction of amounts in or dissolution of the Special Contingent Account, should be carried out once a year, and included in future annual analyses of the Fund's income position.

Mr. Hospedales made the following statement:

The decisions on the principles of burden sharing and on the establishment and funding of the Special Contingent Account were delicate compromises in the Board's search to reconcile the interest of Fund creditors and debtors, while ensuring at the same time that the Fund's financial integrity and credibility are maintained. The well-established cooperative character of the Fund made possible an approach that provides for the sharing between debtor and creditor countries of the costs to the Fund's financial position of overdue financial obligations. The Board has agreed, therefore, to a simultaneous and symmetrical adjustment of the rate of charge and the rate of remuneration to meet the cost of deferred charges, as well as to generate amounts to be placed to the Special Contingent Account. That envisages, in the view of this chair, the possibility of reducing the floor for the remuneration coefficient, if the occasion arises.

Nevertheless, the carry-over of deferred charges from a previous quarter has provided an element of flexibility in the procedures, thereby creating an element of predictability in the rate of charge for a large number of members, which is so important for their financial planning horizons. We continue to support this delicate and carefully worked-out compromise, despite our well-known reservations about the establishment of the Special Contingent Account. The fact that the level of

precautionary balances has risen by 7 percentage points since the onset of this problem some four years ago should not go unnoticed. Such a buildup is inconsistent with the presumption that members will eventually liquidate their arrears, and forming a judgment that the Fund's assets will be impaired is difficult to justify, in our view. A reduction in precautionary balances will alleviate considerably the increased debt-servicing burden of a large number of members that the proposed 2 percentage point increase in the basic rate of charge represents. The problem of the high basic rate of charge is of serious concern to this chair, and Mrs. Ploix has addressed it well. We need to continue our work for concerted solutions, and I believe that Mr. Nimatallah's proposals merit due consideration in that regard, despite the technical difficulties involved.

The systemic nature of the crisis, and the general willingness of the members concerned to collaborate with the Fund to solve the problem of arrears, led the Governors at the Annual Meetings in Berlin to endorse a revitalized and strengthened approach toward the resolution of arrears. The envisaged international collaborative effort between the Fund, its membership, and the international financial community in general, in support of the comprehensive adjustment efforts of members in arrears is now under way. This imaginative and active process will test severely the cooperative character of the Fund, since this chair seriously doubts that adequate support will be forthcoming in all cases for the large amounts which may be required to enable a country to liquidate its debt to multilateral institutions. While this chair remains concerned about the size of arrears, which has continued to grow, it has noted that the number of countries in arrears has remained relatively stable--four countries account for 80 percent of total overdue obligations, and the eight members that have been declared ineligible to use the Fund's resources account for 90 percent.

For this reason, we would urge all those involved in the intensified collaborative process to ensure the operational viability and success of that process. The Fund might have to become actively involved at some point in these arrangements, by assisting members, through rescheduling its own claims, and accepting payment in local currency. We look forward, therefore, to a positive evaluation of this collaborative approach at the time of the Board's next review of the implementation of the principles of burden sharing. We hope that substantial progress will have been made toward the resolution of difficult and protracted arrears cases by that time. Accordingly, we can go along with the staff proposal to evaluate the balances in the Special Contingent Account, and more generally, of precautionary balances, in the context of the annual review of the Fund's income position. In any event, progress toward the resolution

of arrears through the intensified collaborative process should obviate the need to develop criteria and indicators to determine when a reduction of amounts in, or a dissolution of, the Special Contingent Account may be needed.

Mr. Jalan said that he was grateful for Mrs. Ploix's statement, which had raised some fundamental issues which the Board must bear in mind in considering both the question of burden sharing, and the basic rate of charge, which was to be discussed the following week (EBM/88/178, 12/12/88). A key issue was the role of the Fund and the attractiveness to countries with balance of payments difficulties of approaching the Fund. In principle, the Fund should attempt not to reduce the attractiveness of its resources to countries with balance of payments difficulties, as Mrs. Ploix had pointed out.

His chair was in favor of a financially strong and sound Fund, because it believed that without intrinsic strength and financial soundness, the Fund's credibility would be at risk, Mr. Jalan went on. By the same token, his chair believed that the utility of the Fund as an institution, and its role in solving the balance of payments problems of developing countries, could only be enhanced if there was some certainty, as well as a certain element of concessionality, in the Fund's assistance. At present, Fund borrowers were faced with the problems of dealing with a rising general level of interest rates, changes in exchange rates, the difficulties caused by arrears, as well as the necessity of providing for amounts for the Special Contingent Account and a higher rate of charge. Those problems contributed to a highly uncertain environment for borrowing members.

Both the uncertainty, and the rising cost, of using the Fund's resources were of concern to borrowing members, Mr. Jalan pointed out. Both elements were being exacerbated by the current interest rate environment. It also needed to be borne in mind that the current burden-sharing arrangement had been agreed at a period when interest rates were declining, and the amounts the Fund paid in remuneration were also declining. At that time, a good case could be made for a floor for the remuneration coefficient of 85 percent. However, the Fund was currently facing exactly the opposite situation. Both interest rates and the basic rate of charge were rising. Pressure was also being put on the rate of charge because of the burden of arrears. The appropriateness of the current floor for the remuneration coefficient needed to be assessed in the light of the changed interest rate environment. The Board must ensure that the Fund did not become a high cost and highly uncertain source of funds for developing countries.

The burden-sharing arrangement had been agreed only after intense negotiation, and there were good reasons for not disturbing it at present, Mr. Jalan observed. His chair could thus support the continuation of the current burden-sharing arrangement. Nevertheless, it would be useful to explore other alternatives, including those suggested by Mr. Nimatallah.

In exploring other alternatives, the analysis should go beyond purely legalistic or accounting considerations. The key objective of such an analysis must be to ensure, first, that the Fund remained financially strong, and second, that the Fund became an attractive source of funds for its members, and not only a source of funds of last resort.

The basic rate of charge had been 5.5 percent at the beginning of the financial year, Mr. Jalan recalled, and the Board was now contemplating increasing that rate to 7.38 percent--a very sharp increase. Considering the advisability of keeping the Fund an attractive source of finance, and given the difficult circumstances many members were facing because of exchange rates, arrears, and other factors, some mechanism to moderate such sharp increases in the rate of charge ought to be considered. Some formula should be devised that would attach a reasonable degree of stability to the determination of the rate of charge. As an example, he could envisage a mechanism in which the rate of charge would be adjusted downward by less than what would otherwise be indicated during periods of declining interest rates, thereby accumulating certain amounts that could be set aside in a special account, and used during periods in which interest rates were increasing, to moderate the rate of increase in the basic rate of charge. He was sure that there were other ways to moderate increases in the rate of charge.

He had been persuaded by the arguments of Mr. Fernández Ordóñez that a strong case could be made for dissolving the Special Contingent Account, Mr. Jalan went on. However, he would not press for its immediate dissolution, but wished to stress that the effects of an account like the Special Contingent Account merited examination, especially at a time when the basic rate of charge was about to be increased so sharply. Alternative ways of meeting the arrears problem, along the lines of Mr. Nimatallah's suggestions, ought to be found. If the Board decided that a continuation of the Account was unavoidable, no automatic formula should be applied for determining reductions in amounts in or the dissolution of the Account. As the staff had pointed out, the approach should be a judgmental one, because a mechanistic formula would tend to create more problems than it would solve.

The Chairman commented that sharp increases in the rate of charge were indeed an unpleasant reality, but that the rate of charge was only one factor bearing on members' decisions to use the Fund's resources. Access to Fund resources was another aspect. In his view, the pre-eminent feature of the Fund's assistance was the good design and high quality of Fund-supported programs. The Fund had to make sure that psychological or political side effects did not deter governments from taking the frequently difficult measures associated with an adjustment program, as they were often a precondition for attainment of medium-term viability.

Mr. Posthumus remarked that, from his point of view, the idea of concessional Fund financing had limits. Concessional financing was not the fundamental reason for the Fund's existence. It was important that members not acquire the incorrect notion that the Fund's resources should

be more concessional than the Fund could actually ever afford to make them. At the beginning of the 1980s, countries had approached commercial banks for financing not because of the greater amount of access the banks provided, or a more favorable rate of interest, but because the banks attached no conditionality to their lending. It was now clear where such an approach had led.

Mr. Jalan agreed that the concessionality of the Fund's financing was not the primary issue, but rather the uncertainty of both access to, and the cost of, the Fund's resources. The Fund should not place members in the position of being compelled to borrow on commercial terms, because uncertainty of access to Fund resources and the ultimate cost of those resources caused members to avoid approaching the Fund. The cost of the Fund's resources could increase dramatically over a period of Fund lending. The Fund must ensure that it did not become less attractive than commercial banks.

Mr. Ghasimi made the following statement:

Before commenting on the staff paper, I would like to comment on a procedural matter. During the recent discussion on the work program (EBM/88/163 and EBM/88/164, 11/4/88), many Directors recommended that related topics be clustered together and discussed simultaneously. The issues of burden sharing, the Fund's income position, and overdue obligations are clearly related, and could be discussed in an appropriate sequence. For example, it would have been most helpful to review, in a first meeting, the six-monthly report on overdue obligations, so as to be able to assess the impact of overdues on the Fund's income position. In a subsequent meeting, the Board could have discussed the midterm review of the Fund's income position, as well as the decision on burden sharing.

I shall only address the specific issues raised in the staff paper, namely, the operation of the decision on burden sharing, and the modalities for a reduction in the amounts in, or dissolution of, the Special Contingent Account.

With regard to the operation of the decision on burden sharing, we join previous speakers in expressing our deep concern about the increasing trend of arrears to the Fund. The available information affirms the urgency of seeking means and procedures both to reduce existing arrears, and to forestall the emergence of new cases of overdue obligations to the Fund, through the implementation of effective preventive actions. In this respect, we attach great importance to the early initiation of the intensified collaborative approach to assist countries willing to embark on strong growth-oriented adjustment programs to secure much-needed financial support, so as to enable them to clear their overdue financial obligations to the Fund.

In the meantime, we continue to support current efforts to strengthen the Fund's financial position. However, it is unfortunate that this objective is being pursued through higher charges, which are borne by those member countries that are implementing strong adjustment programs, and are discharging in a timely manner their obligations to the Fund. This is all the more regrettable in the current circumstance, given that the effective rate of charge is expected to rise to a level above 8 percent. We hope that this high rate will not discourage members from seeking the Fund's support at an early stage of their balance of payments difficulties.

We continue to hold the belief that the burden of safeguarding the Fund's financial position should be shared equitably by creditor and debtor countries. We also prefer establishing a system in which the contributions to reserves, as well as to the Special Contingent Account, would be entirely burden shared, and we continue to support a ceiling for the rate of charge. We are concerned about the lack of sufficient support for the staff's proposal to lower the floor for the remuneration coefficient below 85 percent. We hope that the Board will consider favorably such a lowering, even on a temporary basis, next week, so as to compensate for the shortfalls expected during the third and fourth quarters of financial year 1989.

With respect to the modalities for a reduction of amounts in, or dissolution of, the Special Contingent Account, we can go along with the staff proposal to review, on a judgmental basis, the adequacy of the Special Contingent Account in the context of the annual review of the Fund's income position.

We support an analysis and review by the management of the proposals forwarded by Mr. Nimatallah.

Mr. Lombardo made the following statement:

Arrears during the first half of financial year 1989 are concentrated in the same group of member countries as in previous reviews of the burden-sharing mechanisms. Table 1 of the staff paper, and the Treasurer's statement, indicate that the floor for the remuneration coefficient was touched in the first quarter of the financial year, and that it is projected to be touched again in the last two quarters, even taking into account the very high basic rate of charge that will obtain for the second half of the financial year. Flexibility in the existing 85 percent floor for the remuneration coefficient is therefore called for, in order to guarantee effective symmetrical burden sharing, and to allow for a lower basic rate of charge than is currently needed to achieve the target amount of



net income, on present assumptions. A lowering of the floor for the remuneration coefficient below 85 percent would undoubtedly help to stop the deferment of charges from one quarter to another, and enhance the likelihood of reaching the net income target for the financial year. Next Monday, the Board will have the opportunity to analyze further that matter, as it is directly related to the Fund's income position. We will then express our concrete ideas on the modification of the remuneration coefficient floor.

In the longer term, we hope that the collaborative approach to resolving cases of protracted arrears that was supported in Berlin will result in an easing of the burden currently placed on the entire membership, and that a reassessment of the projections for deferred charges will thus be feasible in the future. In that context, promising negotiations with Guyana are currently in progress, two members--Honduras and Jamaica--have settled recently all of their overdue obligations to the Fund, and Zaire has made a partial payment of its obligations.

The time has come to consider seriously the reduction of amounts in, or the dissolution of, the Special Contingent Account. No further increase of the amount in the Account could at least be agreed, pending the outcome of the cooperative approach. We agree with the staff that the annual reviews of the Fund's income position could be a good opportunity to analyze the adequacy of precautionary balances in general, and the holdings in the Special Contingent Account in particular. During these annual reviews, a judgmental approach should be used, taking into account all the relevant factors and indicators that are available on each occasion. We would prefer not to attempt to determine precisely at this time which indicators would be more appropriate. The analysis of indicators, however, should not be disregarded in future work, because if they are managed flexibly and cautiously, they can be useful; otherwise, they can be misleading.

It is very difficult to determine the quantifiable factors that the Board might use to evaluate the level of precautionary balances in the Fund. It is still more difficult to link an adequate level of precautionary balances to indicators, particularly when these links are of a quantitative and mechanistic nature. A judgmental approach is therefore called for in determining the reduction of amounts in, or the dissolution of, the Special Contingent Account. Recent developments in the settlement of overdue obligations and the promising prospects for the cooperative approach support this chair's position that--at least--additional funds should not be placed to this Account.

Mr. Posthumus said that the discussion reminded him of the old Latin saying, that the Senate deliberated, while Rome burned. It appeared that no agreement could be reached on whether or not there was a problem with arrears, much less on revising the mechanisms that had been established to deal with arrears, such as the Special Contingent Account.

From the latest information, it appeared that a lowering of the floor for the remuneration coefficient below 85 percent would be necessary in order to allow for a symmetrical burden sharing of the cost of deferred charges, Mr. Posthumus stated. Although it was not necessary to come to a decision on that point at present, he hoped that the opposition in the Board to lowering the floor for the remuneration coefficient would be less, and he agreed fully with Mrs. Ploix in that respect. Such a lowering of the floor would be necessary not only to finance the deferred charges, but to ensure that deferred charges were not shifted into another quarter, or even into another financial year, and that the amounts placed to the Special Contingent Account were burden shared.

He concurred fully with Mr. Nimatallah's suggestions, and his own suggestion was along the same lines, but would go one step further, Mr. Posthumus remarked. He would recommend that the remuneration coefficient be considered both as a floor and as a ceiling; but that any amounts garnered above the ceiling be placed into the Special Contingent Account--not a separate account--itself. He would be in favor of lowering the floor and ceiling for the remuneration coefficient to 80 percent immediately, thus making it possible either to finance deferred charges or additional payments to the Special Contingent Account by increasing charges and lowering remuneration.

He continued to be concerned about the Fund's financial position, Mr. Posthumus went on, and not about the prospects of the Fund's new approach to the resolution of arrears. In fact, that approach was so new that it was impossible to be cynical about it already. The Special Contingent Account represented a rather limited contingency, in his view, and he believed that increasing the amounts in it, to a limited extent, was desirable. He had heard a number of Directors speaking in favor of additional contributions to the Account, but he had not heard many suggestions as to how those contributions were to be financed. By placing additional amounts to the Special Contingent Account in the way he had suggested, the financing of deferred charges might be possible once the floor for the remuneration coefficient of 80 percent was touched in a given quarter. Of course, the amounts that were used for such financing would need to be of an order that would not jeopardize the target amount of increases in the Account that the Board had decided upon at the beginning of the financial year.

He concurred with Mrs. Ploix's remarks about the fairness of the present system of financing overdue charges, Mr. Posthumus concluded. Nevertheless, a system had been established--admittedly temporary--that he did not believe was completely unfair. Therefore, it should not be discarded.

Mr. Zhang made the following statement:

We welcome this opportunity to review the implementation of the principles of burden sharing.

This chair has taken note of the fact that overdue charges have continued to increase in recent months, and, according to staff projections, shortfalls will again emerge for the third, and possibly the fourth, quarters, if members do not settle overdue obligations, or if the average SDR interest rate continues to rise noticeably. Although those projections are subject to uncertainties and based on worst-case scenarios, they are still a cause for concern. It is our hope that the intensified collaborative approach intended to resolve cases of protracted arrears, which was broadly supported during the recent Interim Committee meeting in Berlin, will soon yield positive results. Nevertheless, we also must be realistic, and my authorities wish to reaffirm their support for the principles of burden sharing, that is, that the consequences of arrears on the Fund's financial position should be borne in a simultaneous and symmetrical manner between debtor and creditor member countries, and that the costs that are burden shared would be refundable. In order to observe fully the principle of an equitable sharing of the burden, the floor of 85 percent for the remuneration coefficient needs to be adjusted downward, if the situation so requires.

This chair has expressed reservations about the Special Contingent Account on a number of occasions in the past. As to the reduction of amounts in the Account or its dissolution, we can go along with the proposal that the Board would review regularly the adequacy of the Special Contingent Account in the context of the annual review of the Fund's income position. We also agree to adopt the judgmental approach when considering reductions of balances in the Account, rather than basing such an assessment on a mechanical or predetermined formula. The need for the Special Contingent Account will disappear when the conditions which caused it to be established improve substantially, and with the gradual settlement of overdues and a reduction of financial uncertainties.

Mr. Goos stated that he concurred with the staff's proposal regarding the assessment of additions to and reductions of amounts held in the Special Contingent Account, and he welcomed the presentation of that Account as a part of the Fund's precautionary balances. Consistent with that presentation, it would be appropriate to assess the adequacy of the balances in the Special Contingent Account in a judgmental manner, and not on the basis of automatic formulas. That assessment should take place in the context of the annual review of the Fund's income position.

He believed that the issue of lowering the floor for the remuneration coefficient, as well as Mr. Nimatallah's proposal to consider the floor also as a ceiling, would need to be discussed at the forthcoming review of the Fund's income position, Mr. Goos remarked. In light of the new information on the prospects for deferred charges, there appeared to be no pressing need for changing the existing approach, at least at present. That did not imply that his chair was not concerned about the Fund's financial situation. However, rather than widening the scope for accommodating deferred charges, the Fund should concentrate on strengthening the effectiveness of the existing procedures for dealing with arrears. The proposal to treat the remuneration coefficient also as a ceiling might carry some procedural advantages from the point of view of streamlining the mechanism for dealing with arrears, but he could see no other advantage, especially since the current procedure allowed for the deferral of nonaccrued income into the subsequent quarter. He could also perceive disadvantages in streamlining the arrears procedures. Attempts to deal smoothly with arrears were inappropriate given the seriousness of the arrears situation. Instead, the Board should take every opportunity to discuss arrears problems, so as to exert pressure on countries in arrears.

He supported Mr. Nimatallah's proposal to alter the burden-sharing formula so as to include nondebtor and noncreditor Fund members, Mr. Goos concluded. His chair had suggested similar changes previously, but the Legal Department had explained that there was no legal basis under the Articles of Agreement to accommodate them. Nevertheless, he could encourage the staff to explore Mr. Nimatallah's proposal in greater depth, provided, however, that it was not known ex ante that the proposal was unworkable.

Mr. Nimatallah observed that the question of including noncreditor and nondebtor Fund members in burden sharing was independent of the question of whether burden sharing should be on a perfectly equitable basis. The matter of improving the equity of the arrangements was a fundamental change, involving legal barriers. He did not wish his proposal to be construed as being along those lines. He would recommend introducing a separate, supplemental, mechanism that would include all Fund members in burden sharing. He was not particularly concerned with perfect equity in that respect.

Another question was whether the pain of contributing to burden sharing should be eased, Mr. Nimatallah continued. That concern was at the heart of his second proposal about considering the floor for the remuneration coefficient--either at 85 percent, or at 80 percent, as Mr. Posthumus had suggested--also as a ceiling, and reserving amounts above that for use in subsequent quarters when the outturn was less satisfactory. He believed that such a mechanism might meet Mr. Jalan's concerns about the sharp increases in the rate of charge.

Mr. Fernández Ordóñez commented that if the Fund did not have the power to make all Fund members contribute to burden sharing, he could

not see how it had the power to make any one member contribute to burden sharing. In effect, how could the Board force some members to support burden sharing, whereas it could not force all?

The General Counsel said that the term "burden sharing" referred to the combination of two separate mechanisms, one of which applied to debtors, and one to creditors. Debtors to the Fund were those members using the Fund's general resources. There was an express power in the Articles of Agreement which allowed the Fund to levy a rate of charge on the Fund's holdings of the currencies of members over and above the amount of their quotas, excluding reserve tranche purchases. It was in the Fund's power to determine the rate of charge needed to cover--for example--the Fund's deferred income. Under the burden-sharing mechanism, the Fund had decided to increase its rate of charge to take arrears into account on the basis of a fixed formula, so that there was a basic rate of charge, on top of which there was an additional amount that the Board had decided was needed to take arrears into account. The amount over and above the basic rate of charge was to be refunded once the arrears situation improved, and it was left to the judgment of the Fund to decide when that would occur. In sum, the debtors' contribution to burden sharing resulted from an increase in the rate of charge as determined by the Fund under Article V, Section 8.

The Articles of Agreement also gave the Fund an express power to determine the rate of remuneration it paid to creditor members whose currencies the Fund made available in the General Resources Account, the General Counsel went on. The rate of remuneration had a ceiling of 100 percent of the SDR interest rate, and a floor of 80 percent of the SDR interest rate. Under Article V, Section 8, the Fund had the power to determine the amount of remuneration it would pay its creditors within those limits. The floor that the Board had decided of 85 percent for the remuneration coefficient was not an absolute floor, because it could decide by a 70 percent majority to lower it to 80 percent--but it could not lower it below 80 percent. In principle, the Fund had agreed to pay remuneration of 100 percent of the rate of interest of the SDR. However, to the extent that there were arrears to the Fund, and that there was a corresponding increase in the rate of charge, the Fund had decided, so as to make the burden as symmetrical as possible, to lower the floor for the remuneration coefficient to 85 percent. The lowering of the amounts the Fund paid in remuneration was the legal basis for extending burden sharing to Fund creditors. Of course, burden sharing on debtors and creditors was not absolutely symmetrical, because although there was a floor on the remuneration coefficient, and thus a limit on the extent to which the amount of remuneration could be reduced, there was no corresponding ceiling on the rate of charge.

A qualified majority of 70 percent of the Fund's total voting power would be required to take a decision on the rate of charge, as well as to determine the remuneration coefficient, the General Counsel observed.

The Articles of Agreement did not empower the Fund to levy a tax on its members on the basis of quotas, or to impose a contribution on its members on the basis of their quotas, the General Counsel concluded. By paying its subscription to the Fund, each member had discharged the financial obligation that the subscription represented. Article III stated clearly that the Fund could not impose either an increase or decrease in a member's quota; instead, a member had to assent to that on an individual and voluntary basis. Similarly, the Fund had no power to impose financial obligations unless authorized by the Articles. Therefore, if a mechanism along the lines of what Mr. Nimatallah had proposed were to be considered, each member's decision as to whether or not to contribute to such a mechanism on the basis of its quota, or any other criterion that was decided, would be entirely its own.

Mr. Chatah stated that he shared many of the views Mrs. Ploix had expressed. The information provided by the staff indicated that deferred charges, including those that had been carried over from the first quarter, had been fully offset in the second quarter of financial year 1989 by adjustments in the rates of charge and of remuneration, without touching the 85 percent floor for the remuneration coefficient. The more recent projections indicated that it was unlikely that there would be a difficulty in accommodating deferred charges in the last two quarters of financial year 1989, since even in the worst-case scenario, the shortfall would be minimal, and could be easily rolled over to subsequent quarters. Nevertheless, he, like others, attached great importance to the principle of symmetry in burden sharing, and therefore, would consider a reduction in the 85 percent floor in the future if that became necessary.

The refinements that Mr. Nimatallah had suggested in the burden-sharing mechanisms would help maintain symmetry over time, Mr. Chatah commented. Instead of having simultaneous symmetry, there would be staggered symmetry. Mr. Nimatallah's proposals warranted the staff's serious consideration. The proposals did not, of course, deal with the whole problem, especially since the remuneration coefficient floor had often come close to being touched in the recent past. In any case, Mr. Nimatallah's proposals might smooth out the adjustments needed in the rate of charge.

He agreed with the staff and with other speakers that a judgmental approach toward the criteria for determining a reduction of amounts in or dissolution of the Special Contingent Account was appropriate, Mr. Chatah went on. That approach should take into account all the relevant factors, and would be preferable to any mechanistic or rigid set of indicators. Such an approach would be consistent with the approach that had been followed for making additions to the Special Contingent Account. Also, it needed to be borne in mind that in agreeing to the establishment of the Special Contingent Account, many Executive Directors had clearly been opposed to specific provisioning, and thus it was not appropriate to move the Account in that direction at present. He supported assessing the adequacy of the Special Contingent Account in the context of the annual review of the Fund's income position.

He shared the view that had been expressed by Mr. Nimatallah that a more equitable burden sharing that applied to the entire Fund membership was appropriate, Mr. Chatah concluded. He was aware of the legal constraints, as described by the General Counsel, but would welcome the staff's examination of any workable new ideas, including the possibility of a supplementary mechanism for voluntary cost sharing.

Mr. Ismael stated that his chair believed that the burden-sharing mechanism had worked relatively well, and he supported its continuation, in view of the continued accumulation of overdue charges. The symmetry of the system should be restored, however, by limiting the adjustment to the rate of charge to a symmetrical adjustment of the rate of remuneration.

The latest projections indicated that the shortfall for the second half of 1989 was likely to be very modest, Mr. Ismael went on. In accordance with the principle of symmetry, it would be fair to allow the floor for the remuneration coefficient to fall below 85 percent. However, he could go along with deferring the present charges to the end of the financial year if that was the Board's consensus. He believed that the Fund should consider ways to restore the concessional element of the rate of charge, as the current rate of charge was excessive, and placed a heavy financial burden on countries which were making every effort to remain current with the Fund despite their difficult financial positions.

He shared Mrs. Ploix's views about the Special Contingent Account, Mr. Ismael concluded. He also had reservations about the Account, and further additions to it should not be made beyond the target of 5 percent of reserves at the beginning of the financial year. Finally, he favored a flexible approach to the dissolution of the Special Contingent Account.

Mr. Monyake made the following statement:

I agree that the reduction in the amounts set aside in, or the dissolution of, the Special Contingent Account need not necessarily be linked directly to the eradication of overdue charges and repurchases. The primary goal should be to get all parties working together to bring the problem of overdue obligations under control, which will mitigate the financial uncertainties that led the Fund to take additional precautionary means to safeguard its financial position. Furthermore, it should also be recognized that the Special Contingent Account, on its own, is merely an attempt to respond to the symptoms, rather than the causes, of the problem; besides, as Table 2 of EBS/88/219 indicates, it is hardly a satisfactory means of protecting the Fund's financial position. Clearly, a remedy is required.

This chair supports consideration of the adequacy of the Special Contingent Account in the context of the annual review of the Fund's income position. I agree with the staff that the Board must exercise judgment with regard to the criteria that

should guide the reduction of amounts in or dissolution of the Special Contingent Account, and not rely solely on mechanistic formulas. However, the acceptance of a judgmental approach should not rule out attempts to integrate the use of guideposts into the decision-making process, even in the context of such annual reviews. In this connection, it would have been helpful if the staff had explained how the indicators in Table 2 of EBS/88/219 could be used. It would also be helpful to focus on the progress that is being made in the three or four major arrears cases--accounting for the largest share of overdue obligations--through the new collaborative approach, which would be a signal for taking action to scale down the Special Contingent Account.

One must sound a note of caution that continued upward adjustments in the rate of charge, against the background of the floor for the remuneration coefficient, could jeopardize at some point the adjustment effort in some member countries, as those countries might find carrying the additional financial burden that such adjustments entail progressively more difficult. The question might arise as to whether a member undertaking an adjustment program that is being threatened by a sharp increase in the rate of charge could request assistance under the compensatory and contingency financing facility, as envisaged in the paper on the Fund's income position (EBS/88/239).

Like other speakers, we wish to stress that the Board should stand ready to lower the floor for the remuneration coefficient if it becomes necessary. Equity must be maintained in the principle of burden sharing, in keeping with the cooperative character of the Fund.

The Treasurer stated that a supplementary mechanism to include nondebtor and noncreditor Fund members in burden sharing along the lines of that proposed by Mr. Nimatallah would need to be based on voluntary contributions; therefore, the results of the mechanism would depend crucially on whether or not such voluntary contributions were forthcoming. Obviously, it would also depend to a large extent upon whether those members who were expected to contribute actually did so. The staff would analyze and discuss in the subsequent review mechanisms that the Executive Board might wish to consider.

On present assumptions, it appeared that there would be only small shortfalls of income in the third and fourth quarters of financial year 1989, the Treasurer continued. Those shortfalls could disappear if additional payments on overdue financial obligations were made. However, if those shortfalls materialized, and if they were deemed deferred income for the subsequent quarter and for the first quarter of the next financial year, the Fund might not attain its net income target that had been set at the beginning of the financial year. Although the amount would be small



compared with the situation of the previous financial year, it would nevertheless be of some concern to the Fund, which would again be in a position of having to report that the target amount of income had not been attained.

The standard assumptions underlying the staff's projections with regard to the rate of charge for the second half of the financial year were, first, that the rate of interest on the SDR prevailing at the time the projections were made would obtain throughout the rest of the financial year. That rate had been calculated on the basis of the market rate on Friday, December 2, and was 7.38 percent. A second set of assumptions concerned the expected use of Fund resources, and the prospective developments in the remunerated reserve tranche positions, which were a reflection of the use of Fund resources.

Mr. Nimatallah stated that he had been impressed by the General Counsel's explanation of the two mechanisms--one for debtors, and one for creditors--which existed under the burden-sharing arrangements. His proposal could be considered to be a third mechanism, which did not change the other two, but which ensured that the burden-sharing arrangements reached the nondebtor and noncreditor members as well. He was not concerned about the absolute amounts that could be garnered from neutral members, but merely to observe the principle that all Fund members should contribute to burden sharing.

The Chairman then made the following summing up:

We have had an interesting midyear review of the implementation of burden sharing. The method of burden sharing had, of course, been agreed for the financial year, and I did not find widespread support to change it at present. However, there were many interesting proposals to improve the means of sharing the burden of deferred charges on the Fund's financial position; at the same time, a strengthening of the Fund's precautionary balances was seen as important. Although opinions varied as to how such a strengthening could best be achieved, the principle of such a strengthening received the support of a large majority of speakers.

The Board's review of the implementation of the principles of burden sharing took place against a further increase in the level of overdue obligations and a continued rise in overdue charges. Overdue obligations at the end of September 1988 amounted to approximately SDR 2.4 billion, and had risen further to approximately SDR 2.6 billion at the end of November.

Executive Directors stressed the central importance of the new intensified collaborative strategy to solve the problem of overdue financial obligations to the Fund. They hoped that further progress toward a solution of the problem would be possible in the near future. This, it was agreed, would

involve, first and foremost, the adoption of adequate adjustment policies in the countries in arrears, but the involvement of the international financial community, including national authorities and aid agencies, was also necessary. The issue of arrears was clearly of crucial concern to the Fund, but all the partners in the debt strategy--debtors and creditors alike--would need to work to assure that the new approach would succeed.

Directors welcomed the discharge by two members of overdue obligations to the Fund since the issuance of the staff paper. They noted the likelihood that after these settlements, most--though not all--of the charges that might need to be deferred in the third and fourth quarters of financial year 1989 could be covered by simultaneous adjustments of the rates of charge and of remuneration without breaching the floor to the remuneration coefficient of 85 percent of the SDR interest rate. However, that issue would be discussed in the following week, in the context of the midyear review of the Fund's income position.

A number of Directors recalled that the burden of overdue obligation on the Fund's financial position is shared between members paying charges and those receiving remuneration. They noted that there remained a number of member countries which were neither debtors nor creditors to the Fund, which neither paid charges nor received remuneration, and which did not thus participate in burden sharing. Mr. Nimatallah, in particular, emphasized the principle of universal responsibility for financing the costs stemming from overdue obligations, and suggested that the staff come forward with proposals to ensure that all members could contribute to that financing, perhaps in a form that would supplement the current mechanism.

Directors will recall that that issue had received considerable attention in past discussions of burden sharing. While most Directors had on those occasions agreed with the principle of universality, wider burden sharing had not been pursued because the Fund had no authority to implement it. The only way that principle might be put into practice, in consequence, was by the encouragement of voluntary contributions from members. Notwithstanding those considerations, the staff would examine mechanisms the Board might wish to consider to encourage a wider sharing--albeit on a voluntary basis--of the costs to the Fund of overdue obligations, and would prepare a paper for Board consideration should the analysis show that it might be possible to implement such mechanisms.

The staff would also pursue other proposals made by Executive Directors, in particular, those of Mr. Nimatallah and Mr. Posthumus, that the floor to the remuneration coefficient also be regarded as a ceiling, so that the amount of remuneration exceeding either 85 percent, or 80 percent, of the SDR

interest rate would be retained in a separate account to provide the margin for further burden sharing in subsequent quarters, i.e., independently of the level of deferred charges in any particular quarter, while the problem of overdue obligations remained. I suggest that Directors reconsider these issues toward the end of the financial year, when they will need to decide on the implementation of burden sharing for financial year 1990 and beyond, as the current decision on burden-sharing lapses at the end of financial year 1989.

Executive Directors also discussed the criteria that might be taken into account when considering a reduction or dissolution of the Special Contingent Account. Most Directors agreed that, in view of the continuing increase in overdue obligations, the time was not ripe to consider a reduction of balances in *that Account, nor to determine specific criteria that would lead* to an automatic reduction of precautionary balances. It would be preferable to consider those matters in the light of all the factors that influenced the Fund's exposure to financial risk. Accordingly, Directors supported the staff's proposal to evaluate the need for and adequacy of balances in the Special Contingent Account in the context of the annual reviews of the Fund's income position.

#### DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/88/173 (11/30/88) and EBM/88/174 (12/7/88).

#### 3. YUGOSLAVIA - EXCHANGE SYSTEM

The approval of Yugoslavia's exchange restrictions that remain pending agreements with individual creditors under Executive Board Decision No. 8883-(88/88), adopted June 1, 1988, is extended until the completion of the midterm review of the stand-by arrangement, or March 31, 1989, whichever is earlier. (EBD/88/346, 11/30/88)

Decision No. 9035-(88/174), adopted  
December 5, 1988

4. MALTA - TECHNICAL ASSISTANCE

In response to a request from the Maltese authorities for technical assistance in the fiscal field, the Executive Board approves the proposal set forth in EBD/88/345 (11/30/88).

Adopted December 5, 1988

5. APPROVAL OF MINUTES

a. The minutes of Executive Board Meetings 88/58 through 88/61 are approved. (EBD/88/341, 11/23/88)

Adopted December 1, 1988

b. The minutes of Executive Board Meetings 88/62 and 88/63 are approved. (EBD/88/344, 11/29/88)

Adopted December 5, 1988

6. EXECUTIVE BOARD TRAVEL

Travel by Executive Directors as set forth in EBAP/88/260, Supplement 1 (11/30/88), EBAP/88/291 (11/30/88), EBAP/88/292 (12/1/88), and EBAP/88/296 (12/5/88), and by Advisors to Executive Directors as set forth in EBAP/88/293 (12/2/88) and EBAP/88/296 (12/5/88) is approved.

7. TRAVEL BY MANAGING DIRECTOR

Travel by the Managing Director as set forth in EBAP/88/294, Correction 1 (12/5/88) is approved.

APPROVED: June 13, 1989

LEO VAN HOUTVEN  
Secretary