INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 88/108

3:00 p.m., July 19, 1988

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

Executive Directors	Alternate Executive Directors
	S. M. Hassan, Temporary
F. Cassell	C. Enoch
Dai Q.	
C. H. Dallara	
J. de Groote	
A. Donoso	
M. Finaish	
	B. Goos
J. E. Ismael	J. Reddy
	J. Hospedales
	D. McCormack
	D. Saha, Temporary
Y. A. Nimatallah	
	C. Noriega, Temporary
J. Ovi	
	D. Marcel
	G. P. J. Hogeweg
C. R. Rye	
G. Salehkhou	O. Kabbaj
A. K. Sengupta	L. E. N. Fernando
K. Yamazaki	S. Yoshikuni
S. Zecchini	N. Kyriazidis

L. Van Houtven, Secretary and Counsellor
B. J. Owen, Assistant

Also Present

African Department: D. J. Donovan. Asian Department: M. J. Fetherston. Exchange and Trade Relations Department: J. T. Boorman, Deputy Director; A. Basu, K. B. Dillon, M. Fisher, G. R. Kincaid. IMF Institute: O. B. Makalou. Legal Department: R. H. Munzberg, Deputy General Counsel. Middle Eastern Department: A. S. Shaalan, Director; J. Hicklin, M. Yaqub. Treasurer's Department: D. Williams, Deputy Treasurer; D. Berthet, J. C. Corr, G. Wittich. External Auditor: J. M. Eun. Personal Assistant to the Managing Director: H. G. O. Simpson. Advisors to Executive Directors: M. B. Chatah, A. G. A. Faria, K.-H. Kleine, R. Morales, P. Péterfalvy, I. Sliper, A. Vasudevan. Assistants to Executive Directors: N. Adachi, R. Comotto, Di W., V. J. Fernández, B. Fuleihan, J. Gold, S. Guribye, C. L. Haynes, M. Hepp, J. M. Jones, V. K. Malhotra, L. M. Piantini, S. Rebecchini, A. Rieffel, S. Rouai, G. Seyler.

1. OVERDUE FINANCIAL OBLIGATIONS, AND SPECIAL CHARGES - REVIEW

The Executive Directors resumed from the previous meeting (EBM/88/107, 7/19/88) their consideration of a staff paper on overdue financial obligations to the Fund (EBM/88/123, 6/27/88), together with statistical background material and a summary of the development of Fund policies with respect to arrears (EBS/88/124, 6/27/88), and a staff paper on the second annual review of the system of special charges on overdue financial obligations to the Fund (EBS/88/113, 6/7/88).

Mr. Ovi made the following statement:

At the outset, I would like to reiterate the concerns of this chair about the increasing problem of protracted overdue payments to the Fund. We are reaching a point where this issue might seriously damage other aspects of the Fund's operations. We look forward to reaching broad agreement on constructive measures to solve the current arrears problem as well as prevent the occurrence of significant arrears in the future.

The staff has provided a well prepared and thorough presentation of the arrears problem. This chair welcomes the staff paper and its discussion of new ideas and new courses of action. In particular, we find the proposed outline of action to form a good and realistic basis for the continuing discussion on this subject, including the suggestion to introduce some sort of escrow or trust account to assist in the clearance of arrears.

However, before going into more detail, let me offer some general comments on the overall balance of the document, which clearly has to be an exercise in careful balancing of carrots and sticks. It seems to me, however, that whereas the carrots are fairly large and well defined, the overall framework would hardly provide sufficient incentives to prevent new cases of members falling into arrears vis-à-vis the Fund, as several of the suggested sticks would, in practice, be of little significance. If the present situation persists, almost unavoidably one would end up with preventive action in terms of a general tightening of the Fund's lending policies as the major instrument. While tightening might have been warranted in a number of individual cases in the past, we should avoid an overreaction of a more general nature.

What can be done about this? In principle, one can think of a number of disincentives of a more general nature. One possibility would be--as suggested by Mr. Cassell--to try to use as a basis a distinction between countries that cannot pay and those that are not willing to pay. Operationally this would, however, involve significant problems. More importantly, it would open the way to making the Fund decisions more political in nature, rather than the contrary. Therefore, in my view, we

shall have to move very carefully in this area, although I do not rule out the possibility of singling out members that "won't pay" in very extreme cases. Another possibility would be more generally to make the terms of the suggested rescue operations for countries in arrears less attractive. A third possibility would be to increase the risk involved for these countries in maintaining access to other financial resources.

By suggesting that the outlined procedure for collaborative action might be on the generous side, we mean one thing only. Conditions will have to be such that there can be a reasonable expectation that necessary bridge financing to clear arrears will be forthcoming.

Further adjustment in countries in arrears will undoubtedly be necessary. However, in our view there is little doubt that, in general, most of the gap will have to be covered by creditors and donors, and, in our view, in the present document the staff is underestimating the difficulties involved. For the whole exercise to be meaningful, we have to provide some assurance that we--creditors and donors--can actually be expected to deliver.

In our view, creditor/donor countries need to develop much more coherent policies in their handling of the arrears problem. This relates both to their policies with regard to different international financial institutions, as well as directly vis-à-vis debtor countries. Equally important, more coherent policies should be encouraged in this regard in each of our capitals.

It is no secret that development agencies and monetary authorities differ in their view of the seriousness of the Fund's arrears problem. At the same time--and this is the case, at least in the countries of my constituency--financing to clear the arrears problem will largely have to come from development funds. An argument could, therefore, be put forward for widening the scope of the proposed support groups, as suggested by Mr. Dallara. This might also enhance the possibilities of getting firmer political commitments on financing from creditor/donor countries. I should, however, add that my authorities are not, at this stage, convinced that such a widened scope for the proposed support groups would be helpful. They fear that this might instead weaken the traditional role of the Fund.

Also, in order to prevent future arrears cases, we, like Mr. Cassell and others, see a clear need for creditors/donors to reinstate the Fund's preferred creditor status. When the Fund currently is being discriminated against, it is often for good reasons, seen from the point of view of the country in arrears.

By paying other creditors, more financing might become available in the short run. In our view, it is basically up to creditor countries to ensure that the concept of the preferred creditor status of the Fund becomes an operational reality.

Having said this, I shall be very brief on the details of the document. In general, I found myself very much in agreement with Mr. Rye's statement--at least until his views were elaborated upon this morning by Mr. Goos.

On intensified collaboration, let me just say that it is our understanding that the point of reference for the first phase is a shadow program in collaboration with the Fund, and not a regular Fund-supported program. In this context, we attach great importance to the continuation of the established Fund policy of neither approving a program for a member that is in arrears with the Fund--whether supported by Fund resources or not--nor of using the resources of the enhanced structural adjustment facility to directly cover arrears to the Fund. Further, in our view, the actual shadow program should last for at least 12 months. Having said this, we do, however, find the proposals of the U.K. Chancellor of the Exchequer concerning retroactive access to this facility interesting, and we are ready to consider this approach on the basis of a report from the staff.

Like Mrs. Ploix, we are of the view that it is basically the track record of the country during the shadow program period which will be instrumental in generating the necessary bridging financing. Also, I can share most of Mrs. Ploix's views on potential use of the enhanced structural adjustment facility, in particular, that not too great a share of its total resources be used for solving such arrears cases.

On the issue of remedial action, while not ruling out entirely any of the concrete steps put forward, my authorities are generally somewhat reluctant to move in that direction in certain respects. This reluctance applies to communication, which should be for information only and basically to other multilateral financial institutions and, if appropriate, official creditors and donors, but not to private institutions; withdrawal of technical assistance only at a later stage in the process; and compulsory withdrawal to be considered only in very extreme cases. In other areas we are skeptical, for instance, as to the preventive effects of press releases about individual member countries and penalty charges. Only the suggestion that participation in general in quota increase be dependent on settlement of arrears to the Fund meets with my authorities' unqualified support.

This constituency attaches great importance to the introduction of preventive measures. Thus, we believe that the fundamental preventive action is to make sure that Fund-supported programs are financially viable. In cases where financial viability cannot be assured, a shadow program, or prior actions without financial commitments of the Fund, would be more appropriate. In this context, as also outlined in Mr. Cassell's statement, we are not convinced that the proposed establishment of an escrow account based on withheld Fund resources will be helpful.

Finally, I support the proposed decision regarding special charges.

Mr. Donoso made the following statement:

I would like to start by stressing the importance we attach to finding appropriate solutions to the problem of arrears. It is a problem that is keeping the affected members isolated from the financial community with the gravest consequences for them: a problem that imposes costs on those using Fund resources, and one that represents a great danger to the Fund's relevance as a financial institution. The arrears problem is having an impact on the Fund's resources and on its image as an institution able to deal with systemic crises. We are deeply concerned with the present situation. Because of the seriousness of the problem we want to stress the need to approach this review of our policy on the matter as technically as possible and with a view to obtaining practical results.

The problem of arrears is a continued manifestation of the difficulties encountered by some countries in implementing the debt strategy as presently defined. In the main, we have offered no alternative solutions to countries unable to follow the debt strategy. The Fund has insisted to countries in arrears on the importance of accepting its conditionality as the way to regain access to the financing that would enable them to distribute adjustment through time, and to make the correction of imbalances a feasible process. If they do not follow the advice, the Fund no longer cooperates with them. But up to now the Fund has not tried to impose other sanctions on these countries, beyond this approach of more or less abandoning them to their own devices. This, in our view, has represented a realistic compromise.

The approach to the problem of arrears that has evolved, with its mix of at least apparent insensitivity to the difficulties of individual countries, severe moral suasion with respect to the attitude of the debtors involved, and definite reluctance to consider refinancing of arrears to the Fund, has been

successful in one important respect. Many countries facing severe difficulties have endorsed the present debt strategy and have maintained adjustment, or at least have decided to wait for different solutions to their problems while following the prescriptions of the debt strategy without entering into arrears. Many countries have been effectively induced to avoid arrears to the Fund.

On the other side, those countries that for whatever reason have opted for arrears rather than the acceptance of conditionality have remained in that position, as not much, if anything, has been offered to them to alter their original decision.

It is my impression that the fact that the problem of arrears is today concentrated in a few countries with protracted arrears is a result we should have expected from our present approach to dealing with the problem. Given the constraints in facing the general debt problem and the arrears problem, the present situation should not be considered to represent a failure. Still, the seriousness of the problem makes it necessary to review our policies and, if necessary, to reorient the present approach.

The staff has reviewed the present approach and has proposed new policies. We consider that its proposals represent an important departure from the present approach. The staff suggests the introduction of concrete sanctions to bring countries to settle their arrears. We do not consider this new approach to be either appropriate or in the interest of the Fund for several reasons, especially in the case of the most severe sanctions proposed.

First, we have to consider that the debt strategy is in a process of adaptation, and we still do not know the outcome. But it is obvious that the strategy has evolved, and it has evolved in the direction of recognizing the need for debt relief in many cases. The fact that it has evolved is of some importance to us. Today, we find less realistic the approach of two years ago to the problem of less developed countries. At that time, we asked countries to adopt Fund conditionality in exchange for financing without concessionality. Had we insisted at that time on penalty charges to those in arrears, or on further isolating them by bringing other institutions to join the Fund in pressing the countries to settle their obligations, or in asking them to withdraw from the institution, we would probably today be regretting our policies as they would appear mistaken from the present perspective, and as they would have rendered the situation even more difficult.

This experience should make us cautious. We must always keep open the possibility of further evolution of the strategy. In these circumstances, in which we do not have full knowledge of the situation, to apply extreme sanctions involves some important risks and is not something to be recommended in our view.

Second, the fact that in its evolution the debt strategy found a place for debt relief is also important. Could the Fund ask other multilateral, official and commercial creditors for their help in pressing countries to settle their arrears to the Fund, and expect that these entities will not ask later that the Fund shares in the costs of debt relief? Are these other creditors going to be willing to take losses to help the country to pay penalty charges to the Fund? There are real Fund resources involved in the debt problem in general, and we have to worry about protecting them from now on.

Finally, it is very important to realize, in evaluating all the sanctions proposed, that the present situation of countries in arrears involves very high costs for them. If these countries remain in arrears, in spite of these costs, the implication is that most probably the sanctions would have no effective impact. Behind the overdues there are real problems of a different order of magnitude, so to speak, than the loss of technical assistance, the loss of the right to subscribe to a quota increase, or a penalty charge. On the other side, all these sanctions would at some point make it more difficult for the countries and for the Fund to implement a concrete solution if only because they will make it more difficult to re-establish the climate necessary to renew cooperation.

Apart from the suggested sanctions, the staff made an important effort to generate a new positive element to complement the existing approach. After the informal meeting, (IS/88/9), however, I realize that it does not represent a major change.

Behind the scheme proposed, with its support groups and task force of Board members, there is an offer of efforts to arrange financing if the country complies with existing Fund conditionality. I realize that it is very difficult, if possible at all, to imagine something radically different but still consistent with the debt strategy and with the need to avoid incentives for other countries to fall into arrears. But we have to recognize that the Fund has always offered, to countries in arrears, its expertise and efforts to coordinate donors and creditors and finance a program, in the context of its conditionality. In this sense, the differences in the new approach are rather formal.

I still attach value to this particular staff proposal, however, as recent experience indicates that countries do attach importance to a more direct relationship with their official creditors, and to the opportunity to go beyond technical aspects to be able to express wider considerations at that more political level. I would expect that this more direct relationship could be helpful in freeing the Fund of perceptions that affect its efficiency and introduce frictions in its work. Also, the formation of working groups to deal with the problems of a country should help to involve creditor countries in the promotion of the policies of this situation that they themselves have approved and should facilitate the task of assuring the financing for programs.

In our view, we should adopt this positive element in the staff's suggestions.

The Chairman said that, as Mr. Donoso had understood, the conditionality attached to any Fund-supported program, including shadow programs, would be based on the policy the Fund applied to all members using its resources because that was considered to be the best possible course of economic policy for the country concerned, in light of its circumstances. Thus, the more difficult the country's situation, the more justified that conditionality. Yet he had the impression that Mr. Donoso regretted that that was so, and wished to apply different conditionality in such difficult circumstances.

Mr. Donoso replied that he recognized the reasons for the particular type of conditionality the Fund applied, and had no alternative in mind. His point was that countries sometimes did not accept the Fund's recommended policy, for whatever reason--for instance, because of different preferences with respect to the timing of adjustment--and however logical or not those reasons might appear. That situation, in his view, was the principal cause of arrears, because once countries did not accept such conditionality in programs, they no longer had access to Fund financing, or most other types of financing, and were in a situation in which they were unable to pay. The approach proposed by the staff in its paper seemed to add to the difficulties experienced in the past with such an approach by including also sanctions, which were not well justified, in his opinion.

In response to a question by the Chairman, Mr. Donoso recalled that as the Deputy Treasurer had noted at the informal session (IS/88/9), it was technically not possible to know whether a country was unable or unwilling to take action, and he accepted that view. But if, for whatever reason, the country was not adjusting, and was unable, according to whatever criteria might be applied, to follow the Fund's recommended policy, he saw no room for sanctions. If the country was unwilling to pay, sanctions would no doubt generate a reaction that the Fund would not

like. In sum, it was inappropriate to apply sanctions to "unable countries," and it would be counterproductive to apply them to "unwilling countries."

The Chairman remarked that the Deputy Treasurer had said that it was very difficult, but not necessarily impossible, to draw the distinction between the two.

Mr. Donoso added that in practice, to be able to tell the difference, it was necessary to assume greater knowledge of the country than the country itself had. The Fund should not be making interpersonal comparisons of preferences, and indeed, that was the basic and fundamental reason for the Fund's defense of market mechanisms. For instance, if a country had reserves but was not paying the Fund, then the normal assumption would be that they were using them, for instance, to maintain access to trade financing, and so on. Yet a closer look into the situation would reveal a very difficult position. In reality, on a case-by-case approach, he doubted whether a single country would be able to generate reserves simply because the Fund convinced it to do so. The problem was much wider than the situation of the individual country, and went to the debt problem and strategy in general, as others had mentioned.

The Chairman observed that the Fund of course had to pay appropriate attention to the debt strategy, but it had to give priority to safeguarding the resources of the cooperative.

Mr. Salehkhou made the following statement:

> I welcome today's discussion of the difficult and unpleasant issue of overdue obligations to the Fund. I join those who felt that the coverage and content of the papers do not meet expectations. This discussion, in addition to being a semestrial review of the situation, is also to be a basis for a report to the Interim Committee. As such, it should in my view have encompassed more comprehensive and possibly refined recommendations for tackling this problem, which is somewhat blown out of proportion compared to more pressing problems and issues threatening international financial stability. I am of the opinion that the staff paper, in the absence of any genuine effort to analyze the root causes of the problem and short of suggesting any feasible and realistic solution, does not constitute a valid basis for a fruitful discussion by the Interim Committee. To qualify as such, the report to the Committee should integrate all relevant factors, some of which I shall try to summarize.
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> First, contrary to the prevailing perception in this Board, which was reaffirmed during our most recent informal discussion of the subject (IS/88/9), I feel compelled to reiterate that this chair has consistently joined others in expressing its concern regarding the issue of overdue obligations. Three

members of this constituency that use Fund resources have made special efforts to discharge their obligations to the institution on a timely basis. In so doing, these members are being penalized by having to contribute heavily to the alleviation of the effects of overdue obligations on the financial situation of the Fund through the existing inequitable system of burden sharing, which I will discuss later.

It is worth noting that the approval of Fund arrangements is done by a majority of the Board. That majority is clearly held by industrial country creditors. It is no secret that for many of the countries presently in arrears, considerations other than pure technical and/or financial justifications were at play in approving arrangements for these countries. It therefore follows that the moral duty of these important members calls for their financial help to remedy this problem rather than to continue shifting the burden on the shoulder of other developing countries that strive to discharge promptly their own obligations to the institution as well as to other creditors.

We have also consistently maintained that, in addressing these problems, we should keep in mind their origins. True, in many developing countries, for historical and/or other reasons, mismanagement is partly to blame for their current difficulties. However, the collapse of commodity prices since the beginning of the 1980s, compounded by the instability in exchange and interest rates as well as an increasingly hostile external environment, account substantially for the present impasse. Moreover, many of these countries had to cope, at the same time, with severe droughts and other unfavorable climatic conditions and natural calamities. To make matters worse, the onset of the debt crisis led to a sharp curtailing of financial flows by official as well as private creditors. Regrettably, the Fund decided to join in this untimely move, which is ironically viewed by the staff as a preventive and salutary one.

Another important element shaping our position was that in considering cases of overdue obligations, the Fund should make a particular distinction between countries willing to settle their obligations but unable to do so, and those that are unwilling and not cooperating with the Fund, however judgmental such distinction may appear to the staff. For the latter category of countries, we have never rejected the possibility of punitive action, although I fail to see any wisdom in their becoming recalcitrants. The staff has rightly noted the Fund's catalytic role, in reverse, by observing on the first page of EBS/88/123 that "sizable external arrears, particularly arrears to the Fund, have tended to make the task of mobilizing foreign financing increasingly difficult." We would, however, caution against any extreme punitive action against these countries without giving due consideration to the fact that the future course of

policies, adopted perhaps by different administrations, may be quite different. The possibility of such policy reversal should indeed be given due consideration and encouraged. In this connection, while I have no qualms about the status of the Fund as preferred creditor, a point re-emphasized also by Mr. Cassell, I am rather reluctant to consider the payment by a member to some other multilateral institutions--as was recently the case with a member--as a genuine sign of recalcitrancy. The rationale is that in desperate circumstances, the member may opt to meet an obligation to some creditors with the assurance of being provided with further new financing. As much as one may disagree with this rationale, and I certainly share the disagreement, this has also been the case with some Paris Club creditors, and I have seldom, if ever, heard of any formal objection to that effect.

In response to a question by the Chairman, Mr. Salehkhou noted that like the Fund, certain Paris Club creditors had a kind of preferred status conferred on them. Because they made new financing available, those creditors were paid by the debtors, whereas others were not.

The Chairman responded that if the Fund had a status of preferred creditor, it was because all members of the Paris Club conceded that status and made rescheduling of debt contingent upon approval of a Fund-supported program. The agreed minutes of the Paris Club on rescheduling made the situation clear in every case.

Mr. Salehkhou said that he would inform the Chairman of the instances he had in mind. He then continued his statement.

For the category of members unable to meet their financial obligations, however, we have suggested careful consideration of their cases and finding ways of constructively assisting them to overcome their problems with the help of the international financial community, including the Fund. I have noted the customary position of the staff, which does not find it possible to devise objective indicators to make this distinction. While I agree that the staff should not take a judgmental position, I fail to see why the Board could not do so when necessary, with the help of certain objective indicators to be developed by the staff.

In this regard, we have repeatedly emphasized that the solution to these problems, which did not appear overnight, will call for time and patience. A gradual approach with concomitant financial help and technical assistance is required. It is by no means reasonable to expect these countries to be able to adjust their economies in six months' or one year's time and with minimal financing if frequent and successive Fund-supported adjustment programs did not succeed for several years. In

support of such position I have even quoted from the Holy Quran, which urges granting time to those debtors facing difficulties, and I would be surprised if the position would be otherwise with other Godly religions.

A special category of members with overdue obligations includes those who have been forced into this position by falling victims of the Executive Board Decision No. 144-(52/51). One member in this category is believed to have been forced to seek financial assistance from certain nonmembers to become current with the Fund as it was not in a position to meet its obligations by disposing of its own assets, located elsewhere. These cases cannot logically be treated as genuine cases of overdue obligations to the Fund. They may be regarded as cases of forced default and solutions should be sought by the Fund by simply revising or reviewing its own decision to this effect as provided in Decision No. 144 itself. This suggestion has been made by this and several other chairs on various occasions.

Second, the report to the Interim Committee should also address the important problem of the consequences of overdue obligations on the financial situation of the Fund. The subject is treated rather passively in the staff papers. I would suggest that the system of settling charges and burden sharing be fully described in the report and full details of the contributions of creditor and debtor members be disclosed so as to clearly demonstrate what category of the membership should indeed be most concerned by this problem. In light of the projections that obligations of countries with protracted overdue financial obligations to the Fund could soon reach the level of SDR 4 billion, alternative solutions should be presented as a means of alleviating the effects on the debtors who strenuously manage to effect the timely discharge of their obligations. Our preferred solution in this regard has been burden sharing based on quotas which constitute the basis for practically all other decisions in the Fund, policy oriented or otherwise, including approval or lack thereof of Fund arrangements. If this approach continues to be rejected by industrial country colleagues, as I suspect it would be, then we would submit that the burden sharing be operated on an equal basis among debtors and creditors by the abolition of a floor on the rate of remuneration, and/or the imposition of a ceiling on the rate of charge.

Failing to address this question would make the rate of charge unbearable for debtors and could discourage members from seeking Fund assistance at early stages of their problems. Moreover, other countries could thereby be forced to join this category of members with overdue obligations and, given the relatively substantial amounts involved with large borrowers, the outlook is indeed frightening.

Third, as I already mentioned, I fail to see any new and/or realistic proposal in the staff papers. The so-called "constructive approach" consists of what the Board has been trying to follow all along. Shadow programs, which have long been experimented with, have not met with much success. Given the magnitude of the adjustment efforts required in the concerned countries, it is highly doubtful that these shadow programs would succeed without complementary and timely financing. Granted that the staff paper recognizes the need for financing to be provided for essential imports and servicing debt to the Fund in order to keep the arrears from increasing. I wonder, however, which creditors can realistically be expected to meet such huge financing requirements especially when the Fund is to be the primary beneficiary by being fully repaid. Would past experience in this regard give any reason to conclude otherwise? Besides, even when some financing is provided, the creditors generally impose tight conditions for its utilization--such as payment for nonessential imports--that are not conducive to a rapid return to normal conditions. In any case, I fail to see why creditors or banks should logically grant priority to servicing arrears to the Fund. The analysis of the staff should therefore be refined if practical solutions are to be offered. Such solutions for the core group of countries in arrears should be offered with the same political will and spirit as was the approval of arrangements in the first place. It is doubtful that these countries would be able to withstand the shocks that would accompany the required adjustment even if they were willing to do so. Without such analysis the constructive approach would remain a rhetorical exercise, with the debtor countries continuing to bear the increasing brunt of the costs.

As to the punitive actions, or what Mr. Rye calls the sticks, I wish to point out that basically these are by far the only measures that have been utilized. We have on numerous occasions expressed our view that these measures cannot be expected to solve the problem. The best illustration is the information provided by the staff in the paper on special charges and which shows that only 6 percent of the special charges have actually been paid. The logic of the system would lead to the conclusion that in order to recover the Fund's costs it would perhaps become necessary to impose special charges on late payments of special charges. It would therefore be reasonable to conclude that all the measures imposed or suggested in this regard have proven ineffective and that it would be timely to phase them out.

I continue to regret that punitive actions are again given prominence over genuinely constructive cooperative solutions and that solutions envisaged in the Articles of Agreement are ignored altogether.

In conclusion, I wish to reaffirm my opposition to punitive measures, except in cases of proven recalcitrance, and would like to encourage the staff to prepare for the consideration of the Interim Committee a more balanced, comprehensive report which would address the problem from all its angles and suggest more practical rather than emotional solutions. I would also urge the major creditors to make special and adequate financial contributions so as to remedy the problem of protracted cases of overdue obligations to the Fund. Otherwise, serious consideration should be given to the relaxation of the strictly enforced policy preventing the Fund from concluding arrangements with members in arrears.

One last point. If we are to draw on past experience with the issue of members with overdue obligations, I would urge caution on the choice and type of proposals we may include in the report to the Interim Committee. Specifically, if my memory serves me right, I recall that while the Fund, in discussing the first case of a member with overdue obligations rejected outright any meeting with the authorities, who were hoping to find a cooperative solution, even at headquarters, it clearly was forced to relax and reverse such rigid policy in considering subsequent cases.

In response to a remark by the Chairman, Mr. Salehkhou said that he would provide the information in question.

Mr. Dai made the following statement:

It is apparent that the problem of overdue obligations to the Fund has been deteriorating, both in terms of absolute amount and the duration of the overdues. However, it should be noted that the problem continues to remain within the confines of a relatively small group of member countries; moreover, out of a total of SDR 2.1 billion in overdue payments, 83 percent is concentrated in four countries that are in arrears with the Fund. Therefore, it appears to me that the seriousness of the overdue problem lies not simply in the magnitude of the problem (or the increase in the total amount), but mainly in the impact on the economic viability of the members concerned and with the resultant complication for a resolution of the overall debt problem. We agree that exceptional efforts and special arrangements are needed and must be explored at the present stage.

The countries in arrears with the Fund have actually been caught in a vicious cycle of deteriorating difficulties. Arrears with the Fund, especially for the low-income countries, are so heavy that it is impossible for them to settle them with their own resources. Nonetheless, ineligibility to use Fund resources can make it more difficult for them to receive

external assistance from other sources. The resultant growing isolation has thus tended to make it impossible for them to maintain their already very low level of imports, essential to both the preservation of economic growth as well as the prevention of further deterioration.

This chair has always maintained that, given the nature and extent of the severe difficulties facing these countries in arrears to the Fund, we should not lose sight of the fact that the problem of the overdue obligations to the Fund is only a part of the current overall debt crisis in the developing world. As stated in the staff paper, the problem of overdues never existed in the history of the Fund until now. It has only been since 1983-84 that the Fund has been faced with the deepening problem of overdue obligations. It is known to all that the causes of this problem are complex and deep-seated. It cannot simply be attributed to misbehavior on the part of individual countries in arrears to the Fund. Therefore, in addressing the problem of overdues to the Fund, we are of the view that:

(1) The fundamental solution to the overdue problem should be sought and studied within the context of the overall debt strategy.

(2) A thorough and comprehensive analysis should be made on a case-by-case basis in order to find out the root causes and most suitable solution for each country. What are the reasons for arrears? To what extent are they due to exogenous or internal factors, objective or subjective factors?

(3) The focus should be concentrated on the four countries with the largest arrears to the Fund. If the problems of these four countries are solved, then more than 80 percent of the overdues will be resolved.

(4) A collaborative spirit is crucial to the solution. I agree with the staff that "given the pervasive effects of arrears on the Fund and its membership, and the deep difficulties facing many of those now with protracted arrears, it is evident that a resolution of the problem must be collaborative in nature, involving not only the member concerned, but the Fund, its membership, and the international financial community in general."

With this in mind, the general idea contained in the staff paper of an intensified collaborative framework seems to me a positive and pragmatic approach. If the three interlinked phases or elements could be successfully carried out, overdue obligations as well as the overall debt problem of these countries will be greatly relieved. In this regard, we also welcome

the positive elements in the proposal by the U.K. Chancellor to help low-income members with protracted arrears. The proposal is worthy of further study.

Turning to the specific points suggested in the staff paper, I have four comments.

(1) I have no difficulty in general with the idea of forming a support group in order to organize in the initial stage a cooperative effort and, particularly, additional financing for the clearance of arrears in the Fund. However, it is not clear in the proposal whether the operation of the support group is to be authorized or supervised by the Fund. I would appreciate staff clarification on this point.

(2) With the existence of a support group undertaking the role of coordinator, I cannot see the necessity for a task force comprised of certain members of the Executive Board. As I see it, work undertaken by the task force would only be a repetition of that which falls within the jurisdiction of the Board.

(3) While there might be advantages in establishing an escrow account for the purpose of receiving outside funds for settlement of members' arrears to the Fund, I fail to see the point of establishing similar types of escrow accounts as preventive measures upon receipt of resources from Fund financing facilities. If a member receives financing from the Fund to be used to meet forthcoming obligations to the Fund, then what would be the point of receiving such financing in the first place.

(4) I hope the staff can provide us with more concrete analyses on possible external financing, which is very essential for members concerned with settling their arrears to the Fund, especially at the stage when Fund financing cannot be involved.

With regard to those sticks proposed as remedial actions, such as more active publicity, imposition of penalty charges, nonapproval of quota increases, limiting technical assistance to members with overdues, compulsory withdrawal, which are designed to punish those members that do not collaborate, we are skeptical that these punitive measures are in general an effective solution to the overdue problem.

In the first place, I would ask why these members will not collaborate with the Fund. Why do they not accept completely the Fund's program? Why do they not follow unconditionally the Fund's policy requirement? If it is a really good prescription, why do they not take it? If they don't realize it is good medicine, is the big stick likely to be the best and most

effective instrument of education? The best way it seems to me is to find out the causes for the lack of cooperation and then try hard to eradicate those causes.

Second, if a member in arrears is willing to collaborate, then of course there is no reason to use sticks. If a member is really not willing to collaborate, then it is possible that the member does not mind the sticks--not only will it not pay the penalty charges imposed by the Fund, but also it might not be interested in the Fund's technical assistance, for instance, or in a quota increase. The escalation of punitive measures, by increasing publicity or even ousting the member from the Fund, would not help solve the overdue problem but would rather lead to the disruption of relations between the Fund and the member, and might even impair the prestige of and confidence in this international cooperative institution.

Third, economic sanctions have usually been used in international disputes. Sometimes strong reaction by a country to these sanctions has increased tensions between the two parties concerned rather than helped toward finding a solution to the dispute. Therefore, any punitive action by the Fund against its members should be administered with great caution. Even in extreme cases, overaction on the part of the Fund could result in undesirable political repercussions in the international community. We sympathize with those countries with severe economic and financial difficulties, but our emphasis on being more cautious in using sticks should not be taken to understand that arrears are acceptable to us. In fact, we do not agree with arrears, but we also do not agree to eliminating arrears by means of pressure. For a sovereign state, which is different from a business entity or individual debtor, we must take fully into consideration the political implications involved. Disagreements or disputes with members in arrears should be resolved on the basis of the principle of equality and friendly consultations. Sometimes, it may be advisable to use the good offices of a third party in helping members in arrears to settle obligations to the Fund. It is my firm belief that, without mutual trust and understanding between the Fund and the member and without restoration of a member's economic viability and a sustainable improvement in its external position, it would be unrealistic to expect that certain punitive actions or intensification of pressure against the members concerned will facilitate a solution to the problem of overdues. The most helpful and practical approach in finding solutions for such a complex and protracted problem still lies in resolute adjustment efforts on the part of the members in arrears, the promotion of mutual trust and constructive dialogue, and continued close collaboration among all parties concerned.

Finally, we can go along with the proposed decision on special charges.

Mr. Hogeweg made the following statement:

Like others, I welcome this discussion which is part of the process of preparing the report on overdue obligations to the Fund for the forthcoming meeting of the Interim Committee. The emphasis the subject now receives is entirely justified. The problem of overdues is at least in part related to the functions the Fund has taken upon itself in the past decade and the way it has applied its own standards in extending credits in some cases. The problem will have to be resolved satisfactorily in order to prevent a further financial weakening of the institution which could prevent it from playing its essential role.

In my view, preventive action, mentioned in the last paragraph of the staff paper, really comes first in any solution. Before we can hope to get a positive response from those we expect to pay off the arrears to the Fund of members which are currently not in a position to do so themselves, we should make it abundantly clear that the Fund has learned lessons from the past and will make changes which should significantly diminish the chances of the problem recurring in the future. Similarly, it is difficult to induce members, who have set different priorities for themselves, to commit themselves decisively to comprehensive adjustment policies if that would fail to trigger the external support necessary to clear the arrears to the Fund, and it may prove useless to subject these members to remedial actions if their cooperation would not really help. Yet the efforts of the members in arrears themselves are crucial.

As previous speakers have already noted, there seem to have been cases in the past of outside pressure having pushed the Fund into decisions regarding the use of its resources which were not entirely warranted on purely economic grounds. I think it is crucial that the Fund reinforces the application of its rules and standards on conditionality and financing assurances. The Board bears responsibility for the institution.

Also, I think we should realize that the Fund has adapted its lending policies to the needs of its client base. We are now in the business of extending Fund credit to countries which have significant structural and developmental problems, maybe on top of a temporary balance of payments problem calling for the more classical type of use of Fund resources. Since the balance of payments viability of these countries is dependent on aid

flows, it indirectly makes the Fund dependent on these flows. In that sense, it is a logical sequence that we now turn to aid agencies to finance the arrears to the Fund.

In the situation in which the Fund now finds itself, the burden of the arrears to the Fund will have to be borne somehow. There are not many options open. Any course of action carries the risk of indirectly influencing the character of the Fund as the cooperative monetary institution I am sure all of us want to preserve. In many countries, aid agencies are quite separate from the finance ministries and central banks which are responsible for Fund affairs. The people of the aid agencies will have to be convinced that it is in their own interest to clear existing arrears to the Fund because only if the arrears problem is solved can the Fund continue to play its essential part of promoting adequate macroeconomic frameworks for development. We should give, in my view, much more thought to the way we approach these people in concrete cases. It is essential, if we go this route, that we do not fail.

The financial position of the Fund is not yet fully covered in the staff paper. Let me just say that I think the situation clearly calls for a strengthening of the Fund's precautionary balances, in particular, the Special Contingent Account.

On intensified collaboration, I feel there should be an important role for the World Bank in the suggested support groups. I note that a similar remark was made by Mr. Dallara. In essence, the task of these groups seems to be donor coordination. We share the doubts expressed by many others on the task force of Executive Directors. We agree that the establishment of a new track record on the part of the member in arrears is essential, but we should realize that shadow programs also usually need financing. On the bridging financing that may be necessary to allow a country to draw on the resources of the enhanced structural adjustment facility once its track record has been established, we feel this may prove to be a most difficult hurdle to take. It would be highly regrettable if that hurdle, needed essentially for optical reasons, were to cause the failure of the entire scenario. I use the word optical as opposed to cosmetic, which was used this morning, because we should only disburse resources of the enhanced structural adjustment facility to countries whose adjustment efforts truly deserve it and also in amounts that are consistent with the claims of all eligible members to that facility. This issue merits, in our view, further study.

In reply to a question by the Chairman, Mr. Hogeweg said that even if the country's adjustment effort fully justified its use of the resources of the enhanced structural adjustment facility, disbursements could not

take place without prior bridge financing. That turn of events presented a difficult hurdle, and it would be most regrettable if it was allowed to defeat the objective of the exercise. He then continued his statement.

On remedial action, we have strong reservations on the possibility of compulsory withdrawal as an active threat. It may mean the end of the cooperative character of the Fund and it may not be effective. Of course, as a last resort, the possibility of compulsory withdrawal is provided for by the Articles. I note, like Mr. Ismael, for instance that compulsory withdrawal would force the Fund to write off its claims to that member. There may be less formal ways to make sure a member in such circumstances does not profit from its Fund membership. On penalty charges, we have the same doubts expressed by Mr. Cassell, and the same holds for the escrow account as preventive action.

As I said at the outset, the preservation of the Fund's conditionality standards is essential. The messages we send to the world should all confirm that attitude. Programs should lead to a return to a viable balance of payments position, which is not dependent on new concerted credits or significant increases in aid flows. We agree with the staff that the Fund should be particularly cautious in cases where payments to the Fund become large relative to export proceeds or relative to total debt service payments.

Finally, I support the proposed decision on special charges.

Mr. Sengupta made the following statement:

During our previous discussions on overdue financial obligations to the Fund, we repeatedly made the point that the problem of arrears to the Fund is confined to a few members, and it would therefore be necessary to work out country-specific approaches to resolve the problem. We also pointed out that these countries have serious structural problems, and it would therefore be useful to ensure that our approaches correct the structural weaknesses in these economies. We commend the staff for recognizing these points in its approach, which combines in concrete terms the obligations of the debtor countries in making serious efforts of adjustment with the responsibility of the creditors to help them, keeping in mind the structural constraints faced by the individual countries within which their adjustment programs are to be worked out. I like to stress this situation because of the reference to the cosmetic nature of the approach. There is nothing cosmetic about the seriousness of the debtor countries. But Mr. Zecchini is right that provision of bridge financing only, without ensuring the provision of

other factors that are necessary to implement the programs, would be cosmetic. These other factors would include trade and financial policies determining the external environment for the country. But it is equally important that the program design be appropriate--and it cannot be appropriate if the design is uniform and not varied according to the specific structural factors of the country. Such variation is fundamental to a case-by-case approach, and I emphasize this point because there is a big gap in our effort to suitably adjust the program design to make it feasible within the given structural, social, and political constraints. In other words, if a program fails, we must recognize the possibility that the program was not feasible. We may not like the social and political constraints sometimes, but they are real, and if we try to wish them away, the program will not be feasible and will really be cosmetic.

The staff's framework alludes to an initial phase as one that is required to establish the concerned country's new track record in regard to implementation of a strong and comprehensive program of economic adjustment, and that donors would give financial assistance--bridge finance and resources for obtaining crucial imports--if they are certain of the commitment of the country to the adjustment program. This is understandable, so long as commitment implies efforts made to implement the policies. If it is interpreted as success in achieving the targets of the program, one has to be absolutely sure that the design of the program is appropriate and is realistic, that is, economically, socially, and politically feasible. It is here that the perceptions of the authorities matter most and should be fully taken into account.

The bridge finance needed for settlement of the member's arrears to the Fund could be placed in an escrow or trust account, as the staff suggests. But it is not clear when and under what procedures the amounts in this account should be used to settle the arrears. The initial phase for establishing a new track record should not be too prolonged. The escrow account would not have sufficient amounts to settle arrears to the Fund if the discretion as to how much time is needed for establishing such a track record is left entirely to donors and creditors. If the initial phase goes on for months on end, the outcome could at times be frustrating. I wonder whether we could provide a guideline on the duration of the initial phase of adjustment.

We see the rationale for having a support group, but we do not support the idea of having a separate parallel informal task force of Executive Directors of the Fund and possibly of the World Bank. The support group would help the Fund in obtaining repayment of overdues, and basically should be supportive of the efforts of the concerned member to identify and implement a

viable adjustment program. The support group could consist of high-level governmental representatives of donors. It should work in close conjunction with the Fund and the member with overdue obligations. Incidentally, we do not understand how the staff can bring in the World Bank in its statement relating to the escrow account. How is the World Bank to be involved, without its Executive Board being consulted? And if the World Bank is involved, how would you exclude the African Development Bank, the Asian Development Bank, and so on? We must resist the temptation to introduce so-called Fund-Bank collaboration--about which we have a lot of reservations--through the back door, without a thorough discussion of all the issues.

In case the new track record is found to be good and once the arrears to the Fund are settled, it would be necessary for the Fund to provide resources that support a program which brings about sustainable growth and external viability over the medium term. The donor and creditor support would also be crucial for meeting the financing requirements of the country. But access to the Fund's resources should be sufficiently large to give confidence not only to the member but also to donors that the growth-oriented adjustment program could be carried out with confidence. Here we realize that one cannot have a single universalized access limit to meet our concerns. Access limits have to be set on a case-by-case basis, in an appropriate manner. In this connection, we feel that Chancellor Lawson's proposal for retroactive access to the enhanced structural adjustment facility for low-income countries has much to offer, as an incentive for these countries to undertake a shadow program in consultation with the Fund.

On publicity, we believe that it would polarize, as Mr. Cassell has put it, the Fund's relations with the concerned member and create difficulties in the negotiations for eventual settlement. For the same reason, we would not support the idea of specifically identifying the member in the Fund's publications or press communiqués at the time of declaration of ineligibility or in communications to other multilateral institutions or to other financial organizations.

We are opposed to penalty charges for many reasons: I do not want to go into them but would only request the Board to take full note of the Chinese wisdom, so eloquently advocated by Mr. Dai.

The real penalty in a cooperative system is the loss of benefits that would accrue to a member that does not cooperate. If the idea now is to introduce a major approach which is expected to benefit the countries involved, punitive action will only queer the pitch and detract from the country's willingness to make the wholehearted effort a success.

On the withdrawal of technical assistance, we believe that such an action would cut off one of the important points of communication and sources by which the latest developments in a member's economy can be monitored. We are also against compulsory withdrawal of a member from the Fund.

In respect to preventive actions, we agree that the measures that have been taken so far have been helpful. But we do not agree with the suggestion that to prevent the possible emergence or re-emergence of arrears to the Fund, the Fund and the member should set aside some portion of the resources received from the Fund into an escrow or trust account.

We did not support the imposition of special charges, mainly on the grounds that it imposes an additional financial burden on the member in arrears and that it does not help members in their efforts to settle overdue obligations to the Fund. The paper before us has shown that the system of special charges has not been effective or successful. We do not therefore see any reason why we should change our original position on this matter. I would also like to know from the General Counsel how the special charges can be regarded as different from a penalty, in light of Mr. Zecchini's point and in view of our system of burden sharing.

Finally, refusal to allow members in arrears to participate in quota increases would be punitive in nature, but presumably we can come back to this point when substantial issues relating to the Ninth Quota Review are taken up.

The Deputy Treasurer said that he had little to add to what had been said at the informal meeting on July 12 on the matter of willingness to pay and ability to pay. However, it had been helpful to the staff to have an opportunity to respond to Directors' concern that the staff should develop a set of indicators bearing not only on the ability to pay but on the capacity to pay. As Mr. Ortiz had indicated, the distinction was one of nuance. The staff would attempt to develop appropriate criteria, broadly along the lines suggested by Mr. Cassell and other Directors, possibly merging willingness, ability, and capacity, and without taking up the difficult issue of how to draw a theoretical distinction between ability and willingness, an aspect on which the staff had made its position clear at the informal meeting.

Questions had been raised about the escrow account that would be established in the last of the three phases, when the Fund itself would be prepared to commit its own resources in connection with a member's program of adjustment, the Deputy Treasurer continued. That particular account should be regarded as an aspect of reserve management. As the staff had indicated in response to Mr. Kafka's questions at the informal meeting, it would not be possible to have such frequent phasing that disbursements

would be made immediately prior to a potential or actual obligation to the Fund. Charges fell due six or seven times a year; repurchases became due on different schedules--for most members, six times a year, with two half yearly repurchases under the enlarged access policy, and four quarterly repurchases of use of the Fund's ordinary resources. It would be important to have a system that would permit an easy flow of payments, of charges in particular, unassociated with phasing, which would be a matter more of the program design. For that purpose, members should make sure that they held a sufficient amount of SDRs--whether they bought them in the course of a designation period or whether they agreed to retain part of the proceeds of a particular drawing--to avoid delays in payment to the Fund. A number of countries did in fact withhold SDRs from a drawing for the purpose of the payment of charges and repurchases, and there was no particular reason for not generalizing such a system, which the staff certainly did not see as a punitive measure in any way, particularly for members that were re-establishing their creditworthiness and resuming use of the Fund's resources in the context of an adjustment program.

In response to Mr. Donoso's question relating to the possibility of members' subordinating all other debt to the Fund, the Deputy Treasurer said that apart from the legal aspects, which had been explained in previous Board meetings, the suggestion was probably impractical as well as being unenforceable legally. Countries had so many types of payments to make, including, for instance, suppliers credits, that it would probably be impossible for them to accept a specific, formal legal obligation to subordinate all such other debt to their debt to the Fund.

Mr. Donoso remarked that he had in mind certain intermediate situations, in which it might be more practical for a country to subordinate some of the claims on it by other debtors to the claims of the Fund. For example, indebtedness to commercial and financial institutions often necessitated the coordination of a critical mass of financial support when the Fund was discussing the use of resources in support of programs. It would be more practical, and perhaps quite effective, to expect such a partial scheme to work, and some creditors would no doubt also be on the side of the Fund in obtaining repayment.

The Deputy Treasurer said that the member and the Fund could certainly agree, provided the member could do so legally, to subordinate other debt to debt to the Fund, and provided also that the member was in a position to carry out the subordination. But it would be a matter of agreement rather than of the imposition by the Fund of such subordination as a criterion of conditionality.

The Deputy Director of the Exchange and Trade Relations Department said that to the extent that the resources of the structural adjustment facility or the enhanced structural adjustment facility that were placed in the escrow account were used to pay charges and make repurchases of ordinary resources, the reserves of the ESAF Trust would not be affected. The only effect would be related to the quality of the program design under the structural adjustment or enhanced structural adjustment

arrangement because the resources made available would have to be repaid before they could be attributed to the Reserve Account. Of course, if the resources of the structural adjustment facility were not used at all, they would ultimately end up in the Reserve Account of the enhanced structural adjustment facility.

There was clearly a divergence of views among Directors on the nature of the period covered by the shadow program, the Deputy Director remarked. One view was that it should be a period of adjustment, almost to the extent of an absence of financing, whereas others believed that the emphasis should be on financing. Looking at the existing cases of arrears, it was hard to find anywhere a shadow program that would not require fairly substantial financing during the period of the program, even if very substantial adjustment took place. The type of financing involved was that envisaged in the staff paper, namely, to meet minimum import requirements for the adjustment program and critical or essential debt service payments.

The staff had not intended to suggest that there should be a rescheduling by the Paris Club at the beginning of the shadow program period, the Deputy Director explained. It would be for consideration on a case-by-case basis whether the Fund would wish to ask for a Paris Club rescheduling in the absence of a Fund arrangement. Many considerations would have to be borne in mind. For instance, a formal rescheduling might have to be considered because of the implications for the assistance that the donors and creditors could provide in the absence of, as opposed to the presence of, such a rescheduling. Similar considerations would arise with respect to the assistance that non-Paris Club creditors and donors could provide.

In commenting on Mr. Dallara's remarks about the medium-term viability of programs under stand-by arrangements, the Deputy Director noted that for the ten programs presented to the Executive Board over the past year, the staff had presented an analysis and made a statement about the prospects for viability in every case. It was not clear to him whether the dissatisfaction expressed by the Directors was a function of too little analysis, or too abbreviated an expression of that analysis in the staff paper, or whether it was rather a matter of the standards of viability set by the Fund. Certainly, the staff would welcome more guidance from the Board in those areas.

To be more specific, among the ten stand-by arrangements approved in the past year, it had been stated in some cases that viability was not in sight, the Deputy Director added. In other cases, it had been stated that viability was foreseeable, if exceptional financing continued to be provided in the post-program period, and where it was noted that there seemed to be a reasonable expectation, based on previous experience with the country in question or in similar situations, of such exceptional financing being available. In other cases, viability was clearly

foreseeable, and it had been so stated in the staff papers. Unfortunately, a standing rule stating that it had to be shown that the Fund would be repaid would not work in practice.

Another point that had been made was that in many countries, Fund resources were being disbursed for purposes of development rather than adjustment, where it seemed more logical to depend on continued aid flows from aid agencies, the Deputy Director added. Unfortunately, it was difficult to make assumptions about what were normal aid flows, or indeed, about "normal" exceptional financing, but those assumptions had to be made in order to reach a judgment about a country's prospects of viability.

On the functions of the support group, the role of the lead country was partly an organizational one, the Deputy Director said. The natural order of progression was for the lead creditor and donor to a country to play an active role in bringing together other creditors and donors in the process envisaged in the staff paper, and perhaps being itself a significant contributor. One of the main functions of the support group would be, in exceptional circumstances calling for exceptional financing, to determine what the contributions would be and where they could be found. Experience would have to be gained, case by case, and quite possibly, several support groups, for a number of countries, would have to be organized simultaneously if rapid progress was going to be made in dealing with the cases in question. In that connection, it was also for consideration whether the share of the financial burden on participants in the support group would be decided, on a case-by-case basis, or more globally across the number of total cases. A case could be made, he believed, for the latter as being the most appropriate course of action.

As for the monitoring role of the support group, specific monitoring of the adjustment program would fall to the staff and to the Executive Board, which would convey its impressions to the group, the Deputy Director stated. The role of the support group would be more one of encouraging the country to continue with the adjustment effort and to rectify any slippages by making appropriate modifications. The support group would have a similar reactive function with respect to the staff and management, in the sense that it would not be involved in the basic work of designing programs, but would follow the development of the program as it took shape, indicating to the country where it seemed sufficient to elicit the necessary support from creditors and donors. The earlier the staff and the Board had a signal of satisfaction or dissatisfaction with the kind of program that was emerging in the country, the greater the likelihood of success at the critical moment in obtaining support from those creditors and donors.

In referring in its statement to refunding of an escrow account to be used to help meet financial obligations to the Fund and the World Bank, the Deputy Director explained that the staff had not intended to suggest a change from the position stated in EBS/88/123, namely, that payments to the Bretton Woods institutions should be maintained. That position had

been put forward for consideration of the Executive Board, in its consideration of the support group's role, as a way of determining the minimum required debt service payments by a member during the shadow program.

The staff representative from the Legal Department noted that the decision on special charges on overdue repurchases, which had been adopted in 1985, was based on Article V, Section 8(c), and the same legal provision would be the basis for a penalty rate on overdue repurchases. The purpose of the system of special charges introduced in 1985 was to recover costs incurred by the Fund because repurchases were not made on time. The purpose of the penalty rate, as described in EBS/88/123, would be different, and would be to provide an additional incentive for the member to repurchase. It could take the form of an increase in the existing special charge, or of an increase of charges, or a new charge could be introduced. The Articles themselves did not refer to special or penalty charges, but such charges as the Fund deemed appropriate. The main point was that the purpose of charges under Article V, Section 8(c) would cover both the recovery of costs as well as the incentive to make the repurchase. It would be recalled that the Fund's compensation for deferred income through the system of burden sharing adopted in 1986 was designed to deal with the problem of overdue charges, and not of overdue repurchases; consequently, it had no effect on special charges on overdue repurchases.

A special charge on overdue charges to the Fund had also been adopted in 1985, the staff representative recalled, based on the implied powers of the Fund; that power would not extend to the imposition of penalty charges. The remaining issue therefore was whether the existence of the burden sharing mechanism affected the rationale for the special charge on overdue charges, the purpose of which was to recover costs to the Fund. Those costs would need to be further explained in light of the burden sharing decision. However, as an initial comment, there was no complete overlapping between the special charge on overdue charges and the burden sharing mechanism. In fact, the special charge on overdue charges was imposed as soon as the charge was overdue, whereas the burden sharing decision dealt only with any overdue charges that led to deferred income; moreover, the recovery of deferred income took place through a retroactive adjustment.

Mr. Dallara remarked that his concerns were related in part to the depth or comprehensiveness of the staff's analysis, particularly with respect to the ability of a member to repay the Fund and the viability of its situation. But his concern was also related in part to the standards that the Fund applied. That matter could be pursued on another occasion, and he wished to note only that he had been particularly interested in the comment of the Deputy Director of the Exchange and Trade Relations Department that the staff had made it clear, in some cases, that viability was not in sight. In cases in which such analytical conclusions were reached, he wondered how a clear judgment could be arrived at with respect to the safeguarding of the Fund's resources based on adequate assurance of repayment.

The Deputy Director of the Exchange and Trade Relations Department responded that in one specific case, the Managing Director had put special arrangements in place in light of the judgment reached by the staff.

Mr. Cassell remarked that the issue of the support group would no doubt figure largely in the Executive Board's report to the Interim Committee. While there had been fair amount of support for such groups, there was still a considerable degree of skepticism on the part of national authorities about the implications. Therefore, it might be helpful to mention that although the lead country, which as the Deputy Director had noted would play an important organizational role, might well be looked to make a large financial contribution, to view that country's role from such a perspective might discourage countries from taking the lead. It might therefore be preferable, as the Deputy Director himself had suggested, to think in terms of a whole series of support groups operating simultaneously. Certainly, one great merit of such groups might be that national aid agencies would be brought into play their part.

Mr. Sengupta, reverting to his point with respect to the imposition of special charges on charges, said that the case had not been proved that the practice was basically one of covering the Fund's costs. He recognized that when it was a matter of repurchases, the Articles allowed for the imposition of an appropriate rate of charge as seemed by the Fund. But the issue of special charges on charges seemed, according to the Deputy Treasurer, to be a matter of what should be done with respect to members with overdue charges, rather than being a matter of the actual costs to the Fund, which was a purely objective factor.

On another matter, Fund-Bank collaboration seemed to have been introduced, in the references in the outline of action in the staff's statement, to meeting the minimum financing requirements in the initial phase of a member's adjustment program to help meet obligations falling due to the Bretton Woods institutions, Mr. Sengupta observed. He urged that the scope of the discussion not be enlarged in that fashion, because the World Bank might have a different view, particularly on the matter of collaboration. It was preferable to limit the scope of the proposals to developments on the Fund side.

His third point concerned the ability of countries to settle arrears, which was in fact dealt with in the original Article of Agreement along the lines suggested by Mr. Donoso, Mr. Sengupta remarked. As for the difference perceived by Mr. Ortiz between ability to pay and capacity to pay, which the Deputy Treasurer seemed ready to consider, he asked how those two terms could in fact be differentiated.

The Deputy Treasurer commented that the staff would not wish to change its position on the theoretical analysis of ability and willingness, but as a matter of practical application, and starting on the assumption that all members had said that they were willing to pay when they were able to do so, it became a question of the differences in their

ability to pay. Mr. Ortiz's reference to capacity and ability came close enough to suggesting a set of objective indicators for discussion by the Board.

Mr. Finaish recalled that he had asked whether it was legally possible to consider allowing members with overdue financial obligations to accept quota increases, on the understanding that the reserve position created by the quota payment would be used to settle part of the overdue obligations.

As Mr. Salehkhou had observed, two members with overdue obligations were not in a position to settle them because some of their assets were frozen, Mr. Finaish added. Some members had in fact requested a review of Decision Number 144 (52/51) in that connection. Perhaps management could use its good offices between the parties concerned so as to open up the way for the settlement of those particular overdue obligations.

The Deputy Treasurer responded that a member would indeed automatically acquire a reserve tranche position as a result of the quota payment, on the assumption that a reserve payment would be required in connection with the quota increases. However, the use of that reserve tranche position was at the discretion of the member; conditions could not be attached to its use, for instance, for purposes of the payment of indebtedness to the Fund through a drawing on that reserve tranche position.

The Chairman said that he would make a formal summing up of the discussion on the following day, and wished only to make some personal concluding remarks. First of all, the discussions--including the informal discussion on July 12--had been useful, and had in fact revealed how the Board's perception of the problem had changed since the earlier debates in the Board in 1984, as the record showed. But while the Executive Board was certainly more attuned to the realities, the substance of individual positions indicated that a consensus was not yet at hand. The staff had taken the risk, in proposing a strategy combined of sticks and carrots, that three positions were likely to emerge: for sticks, for carrots, and for a blend of both. As a matter of fact, those falling in the latter group had expressed a preference for less of the stick and less of the carrot, meaning that a compromise and an effective strategy were not yet within sight. He trusted that a more constructive position would follow, once the staff had done additional work.

He foresaw further work in four directions, the Chairman went on. First, the Fund must continue to act in accordance with its existing strategy, many elements of which were in fact working quite well. Continued efforts would be made to find concrete solutions to the problems of members currently in arrears, because a new strategy could not be made operational immediately following the Interim Committee meetings.

Second, proposals made by Mr. Cassell and other Directors would have to be examined further, the Chairman commented. The study on how to

differentiate between countries that were unwilling and those that were unable to pay would be made by the staff; the concept of temporary suspension of membership as a step in the gradation of measures could be further examined; and a better definition of the conditions for use of the resources of the ESAF Trust would be needed. Some of the staff's proposals had not received sufficient support; for instance, the proposed task force, which had been seen as a possible instrument for informal cooperation between the Fund and the World Bank, had not engendered broad support. Consequently, it might be necessary to substitute more frequent consideration by the Executive Board of the situation of countries with overdue obligations, if Executive Directors were willing to accept that additional burden, possibly by means of informal meetings. Management and staff might also have to consider the possible need to clarify more explicitly the nature of its contacts with countries in arrears, to overcome the undue impression that might have been given that the arrears problem was being addressed in a punitive or too harsh a manner. Permanent contact was maintained with countries facing arrears problems, in full understanding of their difficulties, which were viewed not in a hostile way but as deserving full consideration, even if the existence of arrears prevented the Fund from being as effective a partner as it would wish. A view would also have to be reached on the advisability of developing appropriate contacts with aid agencies, which would provide a key part of the solution, without of course affecting in any way the monetary character of the Fund.

The report to the Interim Committee would also mention that the Board saw no scope at the present stage for applying certain provisions of the Articles with respect to the rescheduling of repurchases and payment in local currency, the Chairman said, although some Directors did share the view that that possibility should be considered.

The report would obviously have to give appropriate priority to preventive action, and to the need to give more operational content to the Fund's preferred creditor status, the Chairman concluded, and bear in mind the constraints on some member governments in assisting the Fund to resolve the problems of overdue obligations by obtaining the support of the development agencies.

Mr. Sengupta observed that it was true that not much progress had been made with respect to the suggestion of Mr. Kafka and other Directors on applying the provision in the Articles under which the Fund could reschedule repurchases. In a sense, as Mr. Goos had indicated, the way in which bridge financing was envisaged as operating in the staff's proposals, would often be equivalent to rescheduling. Therefore, he wished once more to urge that rescheduling by the Fund not be ruled out ab initio. Furthermore, if it was easier for support groups to accept programs, once arrears were cleared, it would seem preferable for the Fund to remain open minded enough to consider making use of the provision open to it under the Articles to reschedule payments directly, rather than indirectly, through bridge financing.

The Chairman noted that the staff had already prepared papers on that important question.

Mr. Dallara remarked that as the Chairman had noted, it would be necessary for the Fund to move ahead in dealing with individual cases of overdue obligations as best it could, in light of the circumstances in each case. Although it was clear that a broad consensus had not yet emerged in certain respects, for instance, on intensified collaboration and remedial action, it would not seem unreasonable, in specific cases, for management to bring forward particular proposals for collaborative action or, if appropriate, remedial action, to advance its continued effort to deal with the problem of overdue obligations. He made that point because it would probably be easier to face the issue of appropriate action in the context of a particular case.

In response to Mr. Sengupta's remarks with respect to rescheduling, Mr. Dallara observed that any attempt to equate bridge financing with rescheduling under the Articles of Agreement would not only meet with the strong opposition of his authorities, but would have serious adverse implications for the basic financial role of the Fund.

Mr. Hogeweg, referring to Mr. Dallara's suggestion for ad hoc application of certain of the staff's proposals, recalled that in several recent decisions adopted by the Board on members' overdue obligations, explicit reference had been made to the pending review by the Board of the Fund's policies on overdue obligations. It would be necessary for the Executive Board to keep those cases in mind as it proceeded with its review, depending also on the speed with which the process moved ahead.

The Chairman responded that that was why he was anxious to elicit support for a collaborative approach, since agreement on convincing action that could be taken in individual cases was not yet forthcoming. He hoped that it would be possible to reach agreement, upon further reflection, on proposals that could be submitted to the Interim Committee for its endorsement.

The Executive Directors adjourned for the time being their consideration of overdue financial obligations to the Fund.

APPROVED: February 9, 1989

LEO VAN HOUTVEN
Secretary