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SM/86/102

May 14, 1986

To: Members of the Executive Board

From: The Secretary

Subject: Overdue Financial Obligations to the Fund - Ineligibility  
to Use the General Resources and Subsequent Actions by the  
Fund - Legal Aspects

The attached paper, which is scheduled for discussion on Friday, June 6, 1986, is being made available as background material to the discussion on Monday, May 19, 1986 of the six-monthly report on overdue financial obligations to the Fund (EBS/86/98, 4/28/86 and Supplement 1 to be issued shortly).

Att: (1)

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Department Heads

May 14, 1986

To: Members of the Executive Board

From: The Managing Director

Subject: Overdue Financial Obligations to the Fund--Ineligibility to  
Use the General Resources and Subsequent Actions by the Fund--  
Legal Aspects

In response to requests by Executive Directors, the attached staff paper describes a number of possible actions that would be legally available to the Fund in cases in which members have been declared ineligible to use the Fund's general resources. In enumerating these actions, the staff does not take a position on the advisability of applying any (or any set) of them. As has been pointed out in earlier discussions, while a number of actions are legally possible, some may have potential for both positive and negative effects on a member's efforts to settle its obligations to the Fund, and it is difficult to predict, especially without reference to a particular case, which, if any, is likely to be more productive.

Consideration of action by the Fund in a particular case will need to take into account the totality of the member's circumstances. In formulating recommendations in individual cases, the staff and management would be guided by Executive Directors' comments on the various possibilities listed in the paper or others that may be suggested by Directors, the circumstances of the individual cases, and the implications that actions in one case may have for actions in others. Decisions of the Executive Board on any steps to be taken in particular cases will also require difficult judgments as to what is likely to be most productive not only in securing settlement and restoring normal relations with the individual member, but also in serving the Fund's interest in dealing with the overall problem of overdue obligations.

Attachment



INTERNATIONAL MONETARY FUND

Overdue Financial Obligations to the Fund--  
Ineligibility to Use the General Resources and Subsequent  
Actions by the Fund - Legal Aspects

Prepared by the Legal Department

(In consultation with other Departments)

Approved by François Gianviti

May 13, 1986

Introduction

During the discussion by the Executive Board on February 3, 1986 (EBM/86/20) of the situation of a member which had been declared ineligible to use the general resources of the Fund because of its arrears to the Fund, the staff was requested to prepare a memorandum describing the various options available to the Fund with respect to such situations.

The scope of these options is determined by two considerations: the existence of a declaration of ineligibility and the existence of arrears to the Fund.

Accordingly, this memorandum examines the legal consequences of ineligibility and the subsequent actions legally available to the Fund, whether these actions are based on a declaration of ineligibility or the existence of arrears. 1/

The legal status of ineligibility is described in Section I. Other possible actions of the Fund, after a declaration of ineligibility, in the context of overdue obligations in the General Resources Account, are discussed in Sections II and III. More particularly, Section II reviews the actions which may be taken after, but do not require, under the Articles, a prior declaration of ineligibility. Section III examines the only action which, under the Articles, requires a prior declaration of ineligibility, namely, compulsory withdrawal.

Section I. Status of Ineligibility

Before examining the legal consequences of ineligibility, the circumstances in which a member may be declared ineligible to use the general resources of the Fund will be reviewed.

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1/ This memorandum, which deals with ineligibility to use the Fund's general resources, does not examine the consequences of a suspension of a member's right to use SDRs under Article XXIII, Section 2.

#### A. Grounds for Ineligibility

A member may be declared ineligible to use the Fund's general resources under any one of three provisions of the Articles:

(i) Article V, Section 5: ineligibility of a member for use of "the general resources of the Fund in a manner contrary to the purposes of the Fund";

(ii) Article VI, Section 1: ineligibility of a member for failing "to exercise appropriate controls" in order to prevent the use of "the Fund's general resources to meet a large or sustained outflow of capital"; and

(iii) Article XXVI, Section 2(a): ineligibility of a member for failure "to fulfill any of its obligations" under the Articles. 1/

Of these three provisions only Article XXVI, Section 2(a) applies to arrears as a breach of obligations and may lead to the compulsory withdrawal of the member. Therefore, this memorandum will deal exclusively with ineligibility under this Article.

The scope of Article XXVI, Section 2(a) is broad, in that a member may be declared ineligible for the nonfulfillment of any obligation, financial or nonfinancial, under the Articles. It should be noted, however, that pursuant to Article XXIII, Section 2(f) "Article XXVI, Section 2 shall not apply because a participant has failed to fulfill any obligations with respect to special drawing rights". Moreover, ineligibility to use the general resources could not be declared for a failure to meet financial obligations to the Trust Fund, because these are not obligations of the members "under the Articles".

Thus, a member may be declared ineligible if it fails to comply with any financial obligation to the Fund in the General Department, whether in the General Resources Account or the Special Disbursement Account, or with any nonfinancial obligation under the Articles outside the SDR Department.

#### B. Consequences of Ineligibility

A declaration of ineligibility affects the member's use of the general resources of the Fund, but the Articles do not attach any other necessary consequences to the declaration of ineligibility on the member's relationship to the Fund. Such a declaration may, however, have some effects beyond that relationship, for instance, between the member and its creditors.

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1/ See also the specific reference to Article XXVI, Section 2(a) in Article XIV, Section 3.

(a) Consequences Pertaining to the Use of the Fund's General Resources

The consequence that follows necessarily under the Articles from a declaration of "ineligibility to use the Fund's general resources" is, as the phrase indicates, that the right of the member to use these resources is suspended. The member can make no further purchases, including reserve tranche purchases (Article V, Section 3(b)(iv)). <sup>1/</sup> This prohibition on purchases continues until the Fund terminates the status of ineligibility for that member.

Concerning the use of the Fund's general resources, however, the contrast between the rights of eligible members and the status of members declared ineligible has been attenuated by the adoption of certain Rules and decisions.

Rules K-2 and K-4 provide for more flexible actions by the Fund, i.e., the possibility of limiting the use of the Fund's general resources in lieu of a declaration of ineligibility. Under Rule K-2, the Fund may, whenever it is authorized under the Articles to declare a member ineligible to use the general resources, "refrain from making the declaration and indicate the circumstances under which, and the extent to which, the member may make use of the general resources". Under Rule K-4, the Fund may, upon the request of a member that is ineligible to use the general resources of the Fund, or whose use of the general resources has been limited according to Rule K-2, permit the resumption of the use of the general resources with or without special limitations. Unlike Rule K-2, Rule K-4 has never been applied.

The Fund has also adopted policies limiting access to its general resources by members in arrears to the Fund: under these policies, the Fund will not negotiate or approve either a stand-by or an extended arrangement for a member in arrears, and the member may not make purchases under a stand-by or extended arrangement or otherwise (except reserve tranche purchases).<sup>2/</sup> Similarly, a member in arrears cannot use the resources of the Structural Adjustment Facility within the Special Disbursement Account. <sup>3/</sup>

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<sup>1/</sup> See the Commentary on the Proposed Amendment of the Articles of Agreement (1976), p. 21.

<sup>2/</sup> See Decision No. 7908-(85/26), February 20, 1985, amending Attachments A and B to Decision No. 6838-(81/70); EBM/84/54, pp. 37-38; EBM/85/26, Selected Decisions, Eleventh Issue, pp. 70, 71, and 74.

<sup>3/</sup> Disbursements to a member under the SAF are suspended while the member is in arrears to the General Resources Account, the Special Disbursement Account, the SDK Department or the Trust Fund (Regulations for the Administration of the Facility, paragraph 6(2), in the Annex to Decision No. 8238-(86/56)SAF, March 26, 1986).

In sum, the Articles, Rules and decisions provide the Fund with a spectrum of responses to a member in arrears with respect to the use of the Fund's resources.

(b) Other Aspects of the Member's Relationship to the Fund

A declaration of ineligibility to use the Fund's general resources does not affect the member's rights in the SDR Department or its nonfinancial relations with the Fund.

With respect to the SDR Department, Article XXIII, Section 2(f) provides that: "The right of a participant to use its special drawing rights shall not be suspended because it has become ineligible to use the Fund's general resources...." Similarly, the Fund could not deprive a member of its right to receive an allocation of SDRs in the Fund because of ineligibility.

With respect to nonfinancial relations between the member and the Fund, a declaration of ineligibility does not alter the member's rights and obligations under the Articles. For instance, the member's voting rights may not be reduced or suspended. As for Article IV consultations, which comprehend regular Article VIII and Article XIV consultations and are mandated by the Articles as part of the responsibilities of the Fund and the duties of the members, they could not be discontinued.

(c) Consequences outside the Fund

A declaration of ineligibility is likely to have substantial effects, especially in terms of the member's financial reputation, outside the Fund. Ineligibility, while only preventing the member's access to the Fund's general resources, is often perceived by the member's creditors as a finding by the Fund of the member's lack of creditworthiness. This perception is not necessarily accurate, because ineligibility may have been declared for nonfinancial reasons. 1/

In some cases, the member's contractual arrangements with its creditors specifically provide for the consequences of a declaration of ineligibility by the Fund on their financial relations. For instance, loan agreements between members and commercial banks have sometimes included provisions that specifically suspended the member country's right to disbursements, or required immediate repayments, if the member became ineligible to use the Fund's general resources. In recent years, however, the right to disbursements under commercial banks' loans has been increasingly linked to the existence of an upper credit tranche arrangement with the Fund and to purchases having been made by the member

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1/ For instance, Czechoslovakia was declared ineligible on November 4, 1953 for failing to furnish to the Fund the minimum information necessary for the effective discharge of the Fund's duties, as prescribed in Article VIII, Section 5(a), and to consult the Fund in accordance with Article XIV, Section 4 (LBM/53/81).

under such an arrangement. As a result of the fact that, under Fund arrangements, the member's right to make purchases is interrupted as soon as it incurs arrears to the Fund, disbursements under such loan agreements may be suspended well before the member is declared ineligible by the Fund. Similarly, the suspension of purchases from the Fund may accelerate the maturities for repayment of the member's debts to other creditors.

Section II. Actions that do not Require a Prior Declaration of Ineligibility

The Fund may take various actions with respect to a member in arrears, with or without a prior declaration of ineligibility. The Executive Board has already considered several of these actions in the context of arrears, but it has not yet given the same consideration to these actions in post-ineligibility cases.

In cases of arrears, prior to a declaration of ineligibility, Executive Directors have generally emphasized the importance of keeping the channels of communication open and of maintaining contacts with members in arrears. <sup>1/</sup> The Fund can also lend its services and assist a member in finding means of restoring its financial position and becoming current with the Fund. Such assistance has normally taken the form of Fund advice on comprehensive economic adjustment measures which could improve the member's foreign exchange earnings and serve as a basis for financial support from other creditors and donors. It could also focus on action in selected policy areas which, while amounting to less than a comprehensive program, would constitute an important step toward such a program and would encourage a relatively rapid inflow of foreign exchange.

While collaborating with a member, the Fund may take actions to induce the member to normalize its financial relations with the Fund. In its choice of actions, the Fund is bound by the principle of uniformity of treatment of members, but this principle does not prevent it from adopting different policies with respect to members in compliance with their obligations and members in arrears, and, with respect to the latter, modulating its actions to take into account the different circumstances of members in arrears. Several factors might be relevant in this respect, such as the duration of arrears, the relative amount of arrears, and the member's willingness and capacity to pay the arrears.

A declaration of ineligibility, itself one of the actions available to the Fund, does not add to the spectrum of other actions that can be taken by the Fund with respect to members in arrears, except for compulsory withdrawal. It may, however, be taken into account, by the Fund, as a matter for policy decision, when selecting the type of action or determining the intensity of the action vis-a-vis the member concerned.

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<sup>1/</sup> See, in particular, the Board discussions of the Six-Monthly Reports and the Managing Director's Summings Up at EBM/84/167, November 19, 1984, and EBM/85/170, November 25, 1985.

The range of actions available to the Fund includes the following:

(a) Reviews of the member's situation

The Executive Board has expressed its interest in keeping under review the situation of a member in arrears, including after a declaration of ineligibility. Thus, at the time of the last general discussion by the Executive Board of the question of overdue obligations to the Fund on November 25, 1985, the Board decided to review every six months the matter of the arrears to the Fund by a member that has been declared ineligible. 1/

These reviews can focus on specific measures adopted or contemplated by the member or recommended by the Fund to bring about a settlement of the member's arrears to the Fund. Such reviews may, but need not, be combined with Article IV consultation discussions.

(b) Publicity--reports

Under Article XII, Section 7(b), in addition to its Annual Report, "The Fund may publish such other reports as it deems desirable for carrying out its purposes."

Under Article XII, Section 8, the Fund may "at all times ... communicate its views informally to any member on any matter arising under this Agreement" and "by a seventy percent majority of the total voting power, decide to publish a report made to a member regarding its monetary or economic conditions and developments which directly tend to produce a serious disequilibrium in the international balance of payments of members."

The issue of the publication of decisions and information pertaining to members in arrears to the Fund was examined in EBS/84/211, October 11, 1984, and SM/85/12, January 9, 1985. The former proposed the publication in the Annual Report of declarations of ineligibility. The latter discussed the content of press releases issued upon a declaration of ineligibility; three possibilities were enumerated, namely:

- (a) a simple announcement indicating that the member has been declared ineligible because of a failure to meet financial obligations to the Fund;
- (b) an announcement that would, in addition to (a), describe the meaning of the declaration and the facts surrounding the case, e.g., the amounts overdue, the length of time overdue, and the Fund's general policy on the issue;

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1/ "Chairman's Summing Up at the Conclusion of the Discussion on Overdue Financial Obligations to the Fund--Executive Board Meeting 85/170, November 25, 1985," Buff Document 85/206, December 6, 1985, p. 3.

- (c) an announcement going even farther and expressing a view on the part of the Fund about what the member should do in order to become current with the Fund. 1/

On this issue of publication in the Annual Report and press releases, the Board decided

- that aggregate information on financial obligations overdue for six months or more should be included, without identification of the members involved, in the Annual Report as well as in certain other Fund publications; 2/
- that declarations of ineligibility should be reported in the Annual Report, with identification of members concerned; 2/
- that press releases should be issued upon the declaration of ineligibility of a member prompted by the existence of arrears to the Fund; 3/
- to include in the Annual Report the information contained in the press releases, where pertinent. 3/

(c) Technical Assistance

Article V, Section 2(b) provides that: "If requested, the Fund may decide to perform financial and technical services ... that are consistent with the purposes of the Fund." There is consequently no obligation for the Fund to provide technical assistance. As the Fund may use its discretion in the consideration of a member's request, it is open to the Fund to consider withholding the benefit of technical assistance from members declared ineligible. It could also, while continuing to provide technical assistance to ineligible members where appropriate, decide to limit its assistance to finding means, whether direct or indirect, to clear the arrears, and/or decide to charge the member for the cost of the assistance.

In the consideration of an ineligible member's request for technical assistance, several elements would appear relevant, including the Fund's own interest, the circumstances of the member, the purposes of the assistance, and its cost to the Fund.

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1/ "Publicity Upon Declaration of Ineligibility", SM/85/12, January 9, 1985, p. 6.

2/ Decision No. 7931-(85/41), March 13, 1985, Selected Decisions, Eleventh Issue, p. 282; see also EBM/85/41, March 13, 1985 and Chairman's Summing Up, Buff Document 85/58, March 26, 1985, p. 2.

3/ Decision No. 7999-(85/90), June 5, 1985; see also EBD/85/149, June 18, 1985.

(d) Financial measures

Certain financial measures may be taken by the Fund both to safeguard its interests and induce the member to discharge its obligations.

Until now these financial measures have been limited to the imposition of special charges.

On December 30, 1985, the Executive Board decided to impose special charges on overdue repurchases and overdue charges in the General Resources Account effective February 1, 1986: 1/

- pursuant to Article V, Section 8(c), charges on overdue repurchases were "increased by a percentage equal to the excess, if any, of the rate of interest on the SDR over the rate of charge levied ... under Rule I-6(4) or (11);"
- a special charge on overdue charges "equal to the rate of interest on the SDR" was introduced.

These special charges could be increased by the Fund; the special charges on overdue charges, however, could be increased only to the extent that would compensate the Fund's loss of income and administrative costs arising from overdue charges. 2/ Under Article V, Section 8(c) and (d), the Fund has the power to adopt non-uniform rates of charges on overdue repurchases by a 70 percent majority of the total voting power.

Special charges may deter members from falling into arrears, or induce members in arrears to discharge their obligations sooner than they would have otherwise, but they have no effect on members unable or unwilling to discharge their obligations.

The usual remedy, between private parties, of an action in specific performance or damages before a national court raises serious legal difficulties between subjects of international law, and states or international organizations refrain from bringing such actions.

A more effective means of ensuring payment would be to set off claims the Fund may have on the member against the member's claims on the Fund. It would presuppose the existence of reciprocal claims between the Fund and the member and require that the other conditions for a setoff be met.3/

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1/ Decision No. 8165-(85/189)G/TR.

2/ EBS/85/242, October 29, 1985, and Sup. 1, December 16, 1985.

3/ For instance, the separation of assets and liabilities between the General Department and the SDR Department prevents the setoff of claims in one Department against liabilities in the other (Article XVI, Section 2). On the issue of setoff in connection with the retroactive reduction of charges due by a member, see SM/86/90, April 24, 1986, and Decision No. 8271-(86/74), adopted by the Executive Board on April 30, 1986.

As for the sale by the Fund of its holdings of the member's currency, it is possible only within the framework of the Articles, i.e., to other members; the Fund does not have the power to sell holdings of a member's currency to private parties, except in the case of a withdrawing member that does not fulfill its obligation to redeem the Fund's "excess holdings" of its currency, i.e., amounts in excess of the Fund's net indebtedness to the member. Moreover, under the Fund's present policies on the selection of currencies for operations and transactions in the General Resources Account, the Fund will sell a member's currency to other members "only if the member's balance of payments and gross reserve position is judged to be sufficiently strong," and will not normally sell "the currency of a member with outstanding purchases subject to repurchase" without agreement between the Fund and the member. 1/ The Fund could amend its policies on the selection of currencies and decide, pursuant to Article V, Section 7(h), to sell balances of the currency of a member in arrears after consultation with the member. In that event, the member would be required to provide freely usable currency in accordance with Article V, Section 3(e), but the question would arise of the member's willingness and ability to perform its obligation.

(e) Concerted actions

The success of a member that has arrears to the Fund in its efforts to restore normal relations with the Fund depends, in many cases, not only on the member's readiness to adopt corrective measures, but also on the resumption of adequate financing from other sources in support of strengthened policies. The last Six-Monthly Report on Overdue Obligations to the Fund indicated in this respect that, if a sufficient basis existed in the corrective policies being adopted, the staff was prepared to assist the member in presenting its policies to donors and creditors in its efforts to obtain financing. 2/ In his summing up of the discussions of this report, the Managing Director noted broad agreement on several points, including that the Fund should keep open its channels of communication with members in arrears in order to help them formulate adjustment policies and to catalyze external assistance so that concerted efforts could lead to the settlement of arrears to the Fund. 3/

These efforts by the Fund to assist the member to obtain external assistance may be continued in post-ineligibility cases and may even be accentuated. It is in the interest of the Fund, as well as in the interest of a member in arrears, to reach understandings which, through a cataly-zation of additional external resources, will improve the member's financial situation, and thereby enable the member to settle its arrears to the Fund.

One could also consider the possibility of coordinated actions, at the initiative of the Fund, by its membership, in the form of concerted representations to a member in arrears. These representations would

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1/ Decision No. 6274-(79/158), September 14, 1979, Selected Decisions, Eleventh Issue, p. 99.

2/ EBS/85/245, November 5, 1985, pp. 9-10.

3/ Buff Document 85/206, December 6, 1985, p. 1.

emphasize the negative effects on the membership of the nonpayment of arrears, and would impress on the defaulting member the importance of resuming normal relations with the Fund.

### Section III. Compulsory Withdrawal

Membership in the Fund is terminated by voluntary or compulsory withdrawal. <sup>1/</sup> The Fund may compel a member to withdraw only on the grounds and subject to the procedures set forth in the Articles and the By-Laws, which contain several important safeguards:

(i) "If, after the expiration of a reasonable period the member persists in its failure to fulfill any of its obligations under this Agreement, that member may be required to withdraw from membership in the Fund..." (Article XXVI, Section 2(b));

(ii) "Regulations shall be adopted to ensure that before action is taken against any member..., the member shall be informed in reasonable time of the complaint against it and given an adequate opportunity for stating its case, both orally and in writing" (Article XXVI, Section 2(c) which is the legal basis for Section 22 of the By-Laws);

(iii) "Before any member is required to withdraw from membership in the Fund, the matter shall be considered by the Executive Board, which shall inform the member in reasonable time of the complaint against it and allow the member an adequate opportunity for stating its case both orally and in writing. The Executive Board shall recommend to the Board of Governors the action it deems appropriate..." (Section 22 of the By-Laws);

(iv) "...The member shall be informed of the recommendation and the date on which its case will be considered by the board of Governors and shall be given a reasonable time within which to present its case to the Board of Governors both orally and in

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<sup>1/</sup> There have been four cases of withdrawal in the history of the Fund, and only one of them was compulsory. Poland withdrew in 1950, Czechoslovakia in 1954, Cuba in 1964, and Indonesia in 1965; Indonesia rejoined the Fund in 1967. Czechoslovakia was the only member that was compelled by the Fund to withdraw.

Withdrawal from the Fund automatically terminates membership in the World Bank after three months unless the Bank by three-fourths of the total voting power authorizes the continuation of membership (World Bank's Articles of Agreement, Article VI, Section 3). Cessation of membership in the World Bank automatically terminates membership in the International Financial Corporation (IFC's Articles of Agreement, Article V, Section 3) and the International Development Association (IDA's Articles of Agreement, Article VII, Section 3).

writing. Any member so electing may waive this provision"  
(Section 22 of the By-Laws);

(v) Compulsory withdrawal requires "a decision of the Board of Governors carried by a majority of the Governors having eighty-five percent of the total voting power" (Article XXVI, Section 2(b)).

The Executive Board has formally interpreted the provisions of the Articles on compulsory withdrawal (then contained in Article XV, Section 2, now in Article XXVI, Section 2) as follows:

"Action may be taken by the Fund to require a member to withdraw when the following conditions have been met:

1. The member has been declared ineligible to use the resources of the Fund pursuant to Article XV, Section 2(a); 1/
2. A reasonable time has passed since the member was declared ineligible to use the resources of the Fund pursuant to Article XV, Section 2(a), 1/ whether or not a fixed period of time had been prescribed in connection with such action, and the member persists in failing to fulfill its obligations;
3. The member has been informed in reasonable time of the complaint against it and given an adequate opportunity to state, both orally and in writing, any fact or legal argument relevant to the issue before the Fund." 2/

The Board of Governors confirmed this interpretation on September 28, 1954.

The legal aspects of compulsory withdrawal are examined in the following paragraphs. 3/

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1/ Now Article XXVI, Section 2(a).

2/ Decision No. 343-(54/47), 8/11/54, Selected Decisions, 11th Issue, p. 313.

3/ The law and practice of other international organizations appear to reflect a similar approach as in the Fund. Thus, the charters of those international organizations that specifically empower them to expel their members subject this power to certain safeguards. For instance, expulsion is generally possible only if the member has violated one of its obligations to the organization. The power to expel is normally vested in the plenary organ of the organization (i.e., the equivalent of the Board of Governors in the Fund) and the expulsion decision is usually subject to a special majority. International organizations have, in practice, rarely used their power to expel. Thus, among financial international or regional organizations, there has been only one case of expulsion from the World Bank (Czechoslovakia in 1954), and apparently no member has ever been expelled from the IDB, the AsDB or the AfDB. As regards nonfinancial organizations, no member has been expelled from the UN or the OECD. The Council of Europe has expelled one member.

1. Ground for compulsory withdrawal

Under Article XXVI, Section 2(b) as interpreted by the Fund, no member may be required to withdraw unless it has first been declared ineligible under Article XXVI, Section 2(a), i.e., for a breach of its obligations under the Articles (other than obligations in the SDR Department), and has persisted for "a reasonable period ... in its failure to fulfill any of its obligations" under the Articles.

(a) "Persistence in failure to fulfill any obligations under the Articles"

If the member is no longer in violation of any of its obligations under the Articles, the Fund may not require the member to withdraw. Nonetheless, the member remains ineligible until the Fund terminates the ineligibility. Assuming that, after having complied with its obligations, the member commits a new breach, there would be no basis for compulsory withdrawal, because the member would not have persisted in a failure to fulfill its obligations, even if the ineligibility for the prior breach had not yet been terminated.

The opposite conclusion would be reached if, while still in breach of the obligation for which it had been declared ineligible, the member committed another violation, even if the prior breach was subsequently remedied. The member could then be required to withdraw, because it would have persisted "in its failure to fulfill any of its obligations" under the Articles. Article XXVI, Section 2(b) does not require that the member has persisted in its failure to fulfill the same obligation which was initially the cause of the declaration of ineligibility, but refers to any of the member's obligations under the Articles. <sup>1/</sup> Nevertheless, both the fact that the former breach has ended and the nature of the new breach will have to be considered in deciding whether the member should be required to withdraw, and in assessing the "reasonable period" prescribed by Article XXVI, Section 2(b).

(b) "Reasonable period"

Under Article XXVI, Section 2(b) as interpreted by the Fund, a member may be required to withdraw only if:

"...

2. A reasonable time has passed since the member was declared ineligible to use the resources of the Fund pursuant to Article XV, Section 2(a), <sup>2/</sup> whether or not a fixed period of time had been

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<sup>1/</sup> A breach of the member's obligations in the SDR Department, however, would not be a basis for compulsory withdrawal in view of Article XXIII, Section 2(f); nor would the breach of an obligation to the Trust Fund, because it is not an obligation under the Articles.

<sup>2/</sup> Now Article XXVI, Section 2(a).

prescribed in connection with such action, and the member persists in failing to fulfill its obligations" (Decision No. 343-(54/47), August 11, 1954).

Accordingly, the period starts to run on the date the member was declared ineligible to use the resources of the Fund. Moreover, the Fund would have the power--but is not required--to allow the member a fixed period of time to fulfill its obligations before further steps are taken by the Fund toward the member's compulsory withdrawal if it persists in failing to fulfill its obligations. Whether or not such a fixed period has been prescribed, the member may not be required to withdraw until a "reasonable period" after the declaration of ineligibility has elapsed.

Regarding the duration of the "reasonable period", no formal interpretation has been given. The purpose of this condition is to give the member further opportunity and adequate time to reconsider its position, to take appropriate measures, and thereby to comply with its obligations to the Fund. The reasonable period must be judged according to the circumstances of each case. The judgment may take into account, in particular, the nature of the obligation, the causes of the breach, the specific measures needed to terminate the violation, and the capacity and willingness of the member to restore its normal relations with the Fund.

## 2. Procedure

Under Article XXVI, Section 2, and Section 22 of the By-Laws, the procedure for compulsory withdrawal consists of three phases:

- the procedure is initiated by a complaint;
- the Executive Board makes a recommendation;
- the Board of Governors takes the final decision.

### (a) Initiation of the procedure--Complaint

(i) The procedure for compulsory withdrawal is initiated by a complaint issued against the member in breach of its obligations (Article XXVI, Section 2(c), and Section 22 of the By-Laws). This complaint is distinct from the complaint issued prior to the declaration of ineligibility which is dealt with in Rule K-3.

(ii) Who has the authority to issue the complaint? In the absence of specific provisions in the Articles, the By-Laws and the Rules and Regulations, the general principles on complaints under the law of the Fund apply.

Under Rule K-1 and the practice of the Fund, the Managing Director has the authority to make a complaint whenever a member appears to be in violation of its obligations under the Articles. <sup>1/</sup> While the heading of the K-Rules is "Limitation and Ineligibility", the wording of Rule K-1 is broader than the heading, and it can apply in post-ineligibility situations.

Rules H-2 and H-3, on the procedure for complaints by members against other members' exchange measures, assume that a member may complain to the Executive Board that another member is not complying with its obligations under the Articles. It is not required that the complainant be directly affected by the measure; the breach of an obligation by a member is a sufficient basis for a complaint. <sup>2/</sup> Therefore, in spite of the lack of special rules on complaints other than Rules H-2 and H-3, a member has the power to make a complaint whenever another member is in breach of any of its obligations under the Articles. This power has been recognized in the practice of the Fund. <sup>3/</sup>

(iii) The complaint must be based on the finding that "after the expiration of a reasonable period the member persists in its failure to fulfill any of its obligations" under the Articles. It follows that the complaint cannot be made until the "reasonable period" referred to in Article XXVI, Section 2(b) has elapsed. <sup>4/</sup>

(b) Recommendation of the Executive Board

Under Section 22 of the By-Laws, the Executive Board must inform the member in "reasonable time" of the complaint against it and give the member an "adequate opportunity" for stating its case both orally and in writing to the Executive Board.

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<sup>1/</sup> Rule K-1 does not apply, however, to obligations in the SDR Department; complaints by the Managing Director relating to these obligations are made under Rule S-1.

<sup>2/</sup> See also Rule S-2 on complaints by participants with respect to obligations in the SDR Department.

<sup>3/</sup> In the case of Czechoslovakia, the complaint of the United States which initiated the procedure for compulsory withdrawal was based on the continued nonfulfillment by Czechoslovakia of its obligations to furnish to the Fund the information required under Article VIII, Section 5, and to consult with the Fund in accordance with Article XIV, Section 4 (complaint dated June 2, 1954, EBS/54/13; see also the Executive Directors' finding and recommendation on the complaint: EBS/54/13, Sup. 13, August 11, 1954).

<sup>4/</sup> Czechoslovakia was declared ineligible on November 4, 1953. The post-ineligibility complaint was issued on June 2, 1954, i.e., almost seven months after the declaration of ineligibility. The Executive Directors adopted the recommendation to the Board of Governors on August 11, 1954. The Board of Governors decided on September 28, 1954, to expel Czechoslovakia, effective December 31, 1954, i.e., almost 14 months after the declaration of ineligibility.

After the Board has considered the matter, it must recommend to the Board of Governors "the action it deems appropriate." It may recommend the compulsory withdrawal of the member when the conditions prescribed by the Articles are met, i.e., that "after the expiration of a reasonable period the member persists in its failure to fulfill any of its obligations" under the Articles (Article XXVI, Section 2(b)). Even when the conditions of compulsory withdrawal are met, the Board may recommend a different action. It may in particular conclude that the advantages of compulsory withdrawal to the Fund and its membership are outweighed by the disadvantages, such as the release of the withdrawing member from all obligations under the Articles 1/ (e.g., obligations under Article IV, Article VIII, etc.).

The decision including the recommendation may be taken by a majority of the votes cast.

(c) Decision of the Board of Governors

The member must be informed of the recommendation of the Executive Board and of the date on which its case will be considered by the Board of Governors and be given a reasonable time within which to present its case to the Board of Governors both orally and in writing (Article XXVI, Section 2(c) and Section 22 of the By-Laws). The oral presentation may be made at the annual meeting or an ad hoc meeting of the Board.

A decision of the Board of Governors to require withdrawal must be adopted by a majority of the Governors having 85 percent of the total voting power. There is, therefore, a double requirement that (i) a majority of Governors vote in favor of the withdrawal, and (ii) this majority carry 85 percent of the total voting power (Article XXVI, Section 2(b)). 2/ Abstentions have the effect of negative votes.

A decision requiring the withdrawal of a member will normally take effect forthwith. The Board of Governors may decide, however, that the withdrawal will become effective at a later specified date.

When the Board specifies a later date, it may prescribe that the compulsory withdrawal will not become effective if a certain condition is fulfilled before the specified date. For instance, the Board could decide that the member will not be required to withdraw if, by the

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1/ Certain financial obligations continue, after the effective date of withdrawal, until the member's accounts with the Fund have been fully settled (see 3. below).

2/ Prior to the Second Amendment, the Articles prescribed that the decision had to be adopted by "a majority of the governors representing a majority of the total voting power" (Article XV, Section 2(b)). Thus the Second Amendment subjected compulsory withdrawal to the highest majority required by the Articles for decisions of the Fund.

specified date, it has complied with one or more specified obligations under the Articles. 1/

The Board of Governors, while requiring the withdrawal of a member, could assure the member that it will give sympathetic consideration to its subsequent application for membership, if and when certain conditions have been met, such as a satisfactory settlement of accounts with the Fund. Such an assurance, however, would not be a substitute for a membership resolution. Supposing the former member applied for membership, its application would have to be examined by the Executive Board and submitted to the Board of Governors like any other application. A quota would have to be determined, and the Board of Governors would prescribe the terms of membership; in accordance with Article II, Section 2, these terms would have to "be based on principles consistent with those applied to other countries that are already members." 2/

The question may be raised whether the Board of Governors could go even further than a promise of "sympathetic consideration", and adopt two simultaneous decisions relating to the same country: a resolution for compulsory withdrawal, and a membership resolution. Such a procedure would imply that the application for membership was examined and approved while the applicant was still a member of the Fund and was persisting in not fulfilling its obligations under the Articles. Therefore, the Board of Governors would have to find, for purposes of withdrawal, that the member was not able or willing to fulfill its obligation under the Articles, and at the same time, for purposes of membership, that the applicant was able and willing to perform its obligations under the Articles, which is a precondition for membership in the Fund. Such a contradiction would prevent the adoption of simultaneous withdrawal and membership resolutions.

There is no intermediate status between membership and non-membership under the Articles. Therefore, the Board of Governors would not have the power to suspend a member, 3/ i.e., to allow the member to

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1/ In the case of Czechoslovakia, the Board of Governors decided on September 28, 1954 that Czechoslovakia would be compelled to withdraw as of December 31, 1954 unless the Executive Board determined that Czechoslovakia complied by then with its obligations to furnish information to the Fund pursuant to Article VIII, Section 5, and to consult with the Fund pursuant to Article XIV, Section 4.

2/ When Indonesia applied for membership in 1967 after voluntarily withdrawing from the Fund, the membership resolution prescribed terms for the discharge of the amount still owed by Indonesia under the settlement agreement with the Fund.

3/ Ineligibility and limitation on the use of the Fund's resources are a suspension of certain rights. See also Article XXIII, Section 2 on the suspension of the right of a participant to use SURs.

retain its membership while depriving it from all of its rights (except the right of withdrawal) under the Articles. 1/

3. Effects of withdrawal

The Articles do not distinguish between the effects of compulsory withdrawal and those of voluntary withdrawal.

Article XXVI, Section 3 states:

"Settlement of accounts with members withdrawing

When a member withdraws from the Fund, normal operations and transactions of the Fund in its currency shall cease and settlement of all accounts between it and the Fund shall be made with reasonable despatch by agreement between it and the Fund. If agreement is not reached promptly, the provisions of Schedule J shall apply to the settlement of accounts."

"Prompt agreement" means, in practice, within six months of the effective date of withdrawal, because, after that date and in the absence of an agreement, certain provisions of Schedule J will begin to apply (paragraphs 2 and 4), while, until that date, no payment for settlement of accounts under Schedule J can be made (paragraph 1).

In all four cases of withdrawal in the history of the Fund, the Fund and the withdrawing member agreed on the terms of settlement.

Schedule J applies to settlement operations in the General Resources Account, the Special Disbursement Account, and the Investment Account. With respect to termination of participation in the SDK Department, Article XXIV and Schedule H apply.

(a) Settlement in the General Resources Account under Schedule J

If, after offsetting the withdrawing member's claims on the Fund (including an amount equal to the member's quota) against its debts to the Fund (including unpaid charges), the Fund's holdings of the member's currency are not sufficient to pay the net amount due from the Fund, the balance must be paid in a freely usable currency (paragraphs 1 and 2).

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1/ The World Bank's Articles of Agreement contain a provision on suspension of membership (Article VI, Section 2). The Articles of Agreement of IFC (Article V, Section 2) and IDA (Article VII, Section 2) contain provisions to the same effect.

Alternatively, if the Fund's holdings of the member's currency exceed the amount due to the member, the member must redeem these excess holdings in a freely usable currency. Should the member fail to do so within five years of the date of withdrawal, or within such longer period as may be fixed by the Fund, "the Fund may in an orderly manner liquidate in any market the amount of currency which should have been redeemed" (paragraph 4). The Fund may also sell the member's currency to another member (paragraph 5). When a currency has been disposed of under these provisions, the withdrawing member guarantees the unrestricted use at all times of these balances for the purchase of goods or for payment of sums due to it or to persons within its territories (paragraph 6). In addition, the withdrawing member must compensate the Fund for any loss resulting from the difference in the SDR value of its currency between the date of withdrawal and the date of disposal by the Fund (paragraph 6).

(b) Other settlements

Schedule J contains provisions on settlement operations in the Special Disbursement Account and the Investment Account (paragraphs 7 to 9). In the case of loans to a member in the Special Disbursement Account, the member's withdrawal does not modify the terms of its indebtedness (paragraph 7).

Under Article XXIV, Section 1(b), a member that withdraws from the Fund is deemed to have simultaneously terminated its participation in the SDR Department. The rules governing settlement on termination are contained in Article XXIV, Section 2 to 6 and Schedule H.

In the absence of any relevant provision in the Trust Fund Instrument, withdrawal from the Fund would not modify the terms of the member's indebtedness to the Trust Fund.