



Office Memorandum

File
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May 22, 1990

MEMORANDUM FOR FILES

SUBJECT: Executive Board Meeting on Suspension
of Voting and Related Rights, May 21, 1990

This memorandum summarizes the views expressed by the Executive Directors on the staff paper for an amendment of the Articles of Agreement to provide for a suspension of voting and related rights (EBS/90/89, 5/11/90).

At the beginning of the meeting, Mr. Arora made a sober statement referring to this as a "sad day in the history of the Fund" and stating that the amendment of the Articles to provide for suspension of voting and related rights of members would be "detrimental to the cooperative nature of the Fund". His constituency's reservations about suspension had not disappeared even though they were willing to go along with the compromise worked out by the Interim Committee. All Executive Directors from developing countries (except Mr. Al-Jasser) associated themselves with the sentiment of Mr. Arora's statement and requested that it be issued. Mr. Dai after associating himself with the statement abstained from expressing preferences on the issues raised in the staff paper.

Amendment to the Articles to Provide for Suspension of Voting Rights

The staff paper has proposed two alternatives regarding suspension of members' voting rights. Under Alternative 1, the amendment would require that ineligibility precede suspension of voting rights and that such suspension precede compulsory withdrawal. Under Alternative 2, the amendment would permit either suspension of voting rights or compulsory withdrawal, or both, to follow ineligibility. All Directors preferred Alternative 1 as their first choice except for Messrs. Cassell, Filosa, Grosche, Hogeweg, Prader, and Yamazaki, who all but Mr. Filosa expressed their willingness to join the consensus.

The Consequences of Suspension on Elected Executive Directors

All Directors agreed that an Executive Director elected by a group of members should not cease to hold office if a member of his constituency were suspended, but would continue to serve and cast the votes of the non-suspended members until an election of the new Executive Director by the non-suspended members of the group was held. Most Directors, felt that the election should take place within a relatively short period of time. In this context, Mr. Ismael proposed 30 days as a reasonable time period and this proposal was supported by a

large number of Directors (Messrs. Al-Jasser, Dawson, Filosa, Grosche, Landau, Prader, Santos and Filardo's chair).

Termination of Suspension

In the proposed amendment to the Articles "The Fund may, by a 70 percent majority of the total voting power, terminate the suspension at any time". Mr. Ismael pointed out that the Interim Committee agreed on a 70 percent majority for suspension of voting rights, but did not specify the majority needed for a termination of suspension. Therefore, the question of the needed majority was open and he supported a simple majority.

A number of Directors (Messrs. Arora, El Kogali, Filosa, Hogeweg, Ismael and Prader) argued that conditions for termination of suspension needed to be spelled out and should be related to the conditions leading to suspension. Some others (Messrs. Evans, Newman and Thorláksson), however, preferred leaving the conditions for termination of suspension flexible as opposed to defined in the amendment. In this connection, Mr. Gianviti pointed out that the conditions for termination of ineligibility to use Fund resources were not spelled out in the Articles either. Furthermore, the Executive Board may wish to retain the possibility of terminating suspension even though arrears had not been settled (say if the member had adopted a Fund monitored program). Executive Directors emphasized the need for a staff paper on guidelines for the implementation and termination of various deterrent measures in arrears cases; (e.g., suspension, ineligibility, declaration of non-cooperation, compulsory withdrawal). After agreeing on a staff paper on guidelines, Mr. Gianviti indicated that such a paper would not be available by the end of May, when the amendment to the Articles needed to be submitted to the Governors.

Arrears in the SDR department

Mr. Grosche raised the question as to why the suspension of voting rights was not extended to the SDR department. Mr. Gianviti pointed out that the difference between GRA and SDR departments existed in the case of ineligibility to use Fund resources also. Even after suspension, the member would be able to use SDRs but would be left out of the decision making process related to SDRs.

Sena Eken

Sena Eken
Deputy Division Chief
Stand-by Policies Division

cc: Mr. Whittome
Mr. Boorman
Mr. Leddy
Mr. Stuart
Mr. Kincaid



Office Memorandum

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TO: The Managing Director
The Deputy Managing Director

June 16, 1987

FROM: L. A. Whittome

SUBJECT: External Payments Arrears and Policies
for the Use of Fund Resources

The following is a summary of the Fund's position on external arrears.

1. External arrears have special significance in the formulation of policies for the use of Fund resources for they are a reflection of imbalances in external payments flows. In all but a few instances, they involve restrictions on external payments subject to approval under the provisions of Article VIII, Section 2. ^{1/} The Executive Board, in 1970, decided that Fund programs, in cases where external arrears existed, should require both a phased reduction of the arrears and a fixed date for their elimination. In 1980, the Board concluded that when payments arrears were large, their elimination during a program period might not be possible and that, therefore, rescheduling might be necessary. It also concluded that in the early phases of a program it might not be able to do more than avoid a further increase in arrears.

2. In recent years Fund programs generally have involved some aspects of rescheduling and external arrears have existed at the time the use of resources was approved. Programs, therefore, have included a performance criterion specifying a quantified time path for the elimination or reduction of external arrears. Given the large arrears that have been accumulating and the difficulties experienced in reducing them, implementation of policy has reflected the particular circumstances of individual members. For example, of 13 programs in effect in mid-1986 in which external arrears played a role, ten incorporated targets or prior action for elimination of such arrears within the program period; in the other three the targets set fell short of elimination. In eight cases, the program was interrupted owing, inter alia, to a breach of the performance criterion on arrears, and in seven waivers or modifications were granted. In only one case were there substantial deviations from the agreed target.

3. In 1984, the Board recognized that the interruption of spontaneous private lending since 1982 had led to ex ante financing gaps (in other words prospects of extended arrears), given uncertainties regarding the timing and scope of rescheduling and new money packages.

^{1/} External payments arrears are defined for this purpose as all overdue external financial obligations, including those that are not considered to fall under Article VIII.

In some such cases, management has required explicit assurances from creditors on financing during the period of the arrangement, particularly when it seemed unlikely that understanding on compensating adjustment measures could be reached in the event the financing was not forthcoming. In general, requests for use of Fund resources have not been brought to the Board until these rescheduling arrangements had been virtually assured, so that the judgment could reasonably be reached that the financing gap had been filled.

4. In summary, the evolution of the treatment of arrears in Fund programs allows a considerable amount of discretion to management. Whereas the Board is leery of condoning ex ante financing gaps, it has been possible to approve some such programs when there has been reasonable assurance that the gaps would be filled during the program period. In practice, existing and newly arising payment gaps from time to time have been financed by accumulation of arrears; where these have been moderate in size and temporary in nature, programs have proceeded. However, so far, management has exercised its discretion in allowing programs to go ahead despite unresolved arrears only for some African countries, where there was a limited potential for adjustment.

? B.S. [unclear]

cc: Mr. Brown



Office Memorandum

Mr. Whitton

June 15, 1987

MEMORANDUM FOR FILES

SUBJECT: Provisioning for Fund Arrears

At the meeting on Friday, June 12, the Executive Board did not adopt the proposal for provisioning against Fund arrears. The provisioning proposal was supported by Messrs. Dallara, Nimatallah, Rye and van Wijnholds. However, most Directors felt that image problems created by provisioning, and the possible effect of the "writedowns" in weakening incentives for repurchases, outweighed the value of disclosure of value impairment in the Fund's financial statements. Mr. Massé noted that the published statements of the Fund were not used anyway for an evaluation of the strength of the Fund. The recent action by Citicorp seemed to have weakened Directors' support for Fund provisioning. They pointed to the fact that the Citicorp action was still "being sorted out" (Mr. Yamazaki), or that the Fund would be seen as a follower rather than as a leader of banks (Mr. de Groote).

There were difficult technical questions in the discussion and Directors in general indicated their need for more briefing. Mr. Sengupta linked the question of "unusable" currency assets with inconvertibility of currencies, stating that neither approach was valid for valuing the Fund's assets. ^{1/} The outcome of this discussion appeared to be that a compromise would eventually emerge between those seeking increased reserves (a build-up on the asset side) as against provisioning (write-down of assets). A difficulty was that special reserves cannot be distributed back to those providing them and therefore a "separate reserve" might need to be made. Towards the end of the discussion Mr. David Williams clarified that this so-called "nonreserve reserve" would have much the same properties as provisioning. The Managing Director in his summing up noted the general concern of Directors about the adequacy of the Fund's reserves and proposed that the Board expeditiously return to the question on the basis of a new staff paper, following the discussion of the Fund's income this week.

There was no discussion of linkage between provisioning and the strength of the Fund's assets and increased resources for the SAF, although several Directors took the occasion to congratulate the Managing Director on his initiative.

^{1/} The real issue here is not convertibility in private markets as a result of exchange control regulations but convertibility between member governments (usability). The Fund normally arranges for conversion of currencies if this is desired by the purchasing member.

At the request of Mr. Grosche, Mr. de Hopitales clarified that the Brazilian authorities "hoped" for reduced payments to the Fund, through some form of rescheduling, but intended to continue to stay current. His statement was, of course, much welcomed by the Managing Director. (I informed Mr. Brau of this).



P. J. Quirk
Division Chief
Exchange Restrictions Division

cc: Mr. Whittome ✓
Mr. Boorman
Mr. Brau
Mr. Hino

Mr. Whittome

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INTERNATIONAL MONETARY FUND

June 10, 1987

TO : Mrs. Junz
FROM: Peter J. Quirk

[Handwritten initials]

Attached is a draft three-page precis for management of the basis for Fund policies on arrears and rescheduling. Because of the brevity, the note is highly selective in the broad area of policies surveyed, but we think that it contains the main points. A list of references is also attached.

You will notice that recent policies (in the 80's) have been defined less by formal Board decisions, and more by the Chairman's summings up and broad endorsements of conclusions in the documents for discussion. Accordingly, the descriptions of practice under the "case-by-case" approach have assumed more importance, and are therefore reflected within.

Attachment

cc: Mr. Whittome

External Payments Arrears, Debt Rescheduling, and
Policies for the Use of Fund Resources

Articles of Agreement

The basic conditions governing the use of the Fund's general resources relating to the member's adjustment policies are given by Article V, Section 3 of the Articles of Agreement. In summary, the conditions are: (1) the use of resources is in accordance with the provisions of the Agreement and policies adopted under them; (2) there are adequate safeguards that the use will be temporary; (3) balance of payments need exists; (4) the use is subject to total access limits; and (5) the member has not been declared ineligible to use the resources. (4) and (5) are subject to waiver at the Fund's discretion (Article V, Section 4), and Article V, Section 3 (a) provides that the Fund may "adopt special policies for special balance of payments problems."

External Arrears Policies

Policies on external payments arrears assume special significance on two counts: (1) arrears are in direct conflict with a provision of the Agreement, namely, Article VIII, Section 2; and (2) they are a basic manifestation of balance of payments problems. The decision taken by the Executive Board in 1970 ^{1/} noted that the Fund financial assistance to those with arrears should be granted on the basis of performance criteria or policies similar to those for the approval of payments restrictions, i.e., for a temporary period, with a fixed removal date and phased reduction. In general, the elimination would be within the period of the stand-by arrangement and would be reflected in the performance criteria. The policy was qualified by further discussion in 1980, when the Board concluded on the basis of a staff paper ^{2/} that, when payments arrears are large, it might not be possible to aim at elimination in the program period, and special arrangements for renegotiation of obligations might be necessary. It might not be possible, in the early stages of the program to go beyond avoidance of any further increase in arrears. The discussion also concluded that settlements of arrears should not discriminate between creditors, in accordance with Article VIII, Section 3.

Implementation

Implementation of arrears policies has been reviewed annually since 1982. ^{3/} The most recent review (of programs in effect in mid-1986) noted that a specific performance criterion for eliminating or reducing arrears in accordance with a quantified schedule was included in all programs, and that rescheduling was assumed in all programs. In a few instances, stand-by arrangements were approved in principle pending satisfactory arrangements for the financing of an uncovered balance of payments gap, and in one case, agreements with creditors were reached in principle prior to approval of the Fund arrangement. The scheduled mix

of settlement of arrears by cash payments or rescheduling has varied in accordance with a number of factors, including projected medium-term balance of payments developments, and with due regard to conditionality guideline No. 4 relating to domestic social and political objectives. 4/ In some cases, planned token cash payments have signaled the authorities' intentions of meeting overdue obligations, despite an exceptionally weak BOP outlook. In practice, the requirement for nondiscriminatory settlements of arrears has not been interpreted as pro rata distribution between creditors.

Rescheduling

The extent of overall reductions of arrears in Fund arrangements has varied in accordance with members' individual external financing positions, including targets for less than complete elimination in the program period. The adequacy of external financing in Fund arrangements was reviewed extensively by the Executive Board in 1984, 5/ in its examination of approval in principal of Fund arrangements. It was noted in that discussion that until recently programs presented for approval did not contain ex ante financing gaps. 6/ However, with the widespread interruption of spontaneous private lending since 1982, a number of programs for approval have entailed ex ante financing gaps reflecting uncertainties regarding rescheduling, concessional aid flows, and commercial financing. In some cases, management has required explicit assurances from creditors on financing during the period of the arrangement, particularly when it would be difficult or impossible to reach understanding on compensating adjustment measures in the event the financing was not forthcoming. The Chairman's concluding remarks at the 1984 discussion stressed the need for intensive consultations with all creditors so as to seek reasonable assurances on the financing of the program, to permit outright approval. They noted that approval in principle would be reserved for exceptional circumstances in which it would assist the member in reaching agreement with its creditors.

Difficulties of ensuring rapid agreement in the creditors' fora have marked more recent efforts to complete Fund arrangements. In the Paris Club, questions of comparability of treatment have assumed increased importance. There has been an increase in the number of cases where lack of comparable action by nonparticipating creditors has posed difficulties. 7/ Arrears to nonguaranteed suppliers, which tend to be relatively small and diffused, have caused particular problems for coordination. In some of these instances, debtors have made 'unilateral' offers to individual creditors that are taken up over several years; the arrears elimination performance criterion has reflected this gradual reduction.

Commercial banks have increasingly linked disbursements under 'concerted packages' not only to Fund purchases but also to structural reforms supported by the World Bank. 8/ Such linkages in loan covenants and events of default have frequently been rigid and mechanical. Mustering problems with smaller and regional banks have become

increasingly apparent. The Fund's Article VIII approval policies and national bank supervisory policies could be focussed to coerce unwilling participants into rescheduling, 9/ by making the arrears collections unenforceable or unattractive, but discussion has turned increasingly to exit arrangements.

Overdue Obligations to the Fund

In accordance with Article XXVI, Section 2(a), a member may be declared ineligible if it fails to comply with any financial obligation to the Fund in the General Department. 10/ A declaration of ineligibility suspends the right of the member to use these resources, under Article V, Section 3(b)(iv). The member can make no further purchases, including in the reserve tranche. In lieu of a declaration of ineligibility the Executive Board may limit the use by the members of the Fund's general resources (Rule K-2). A declaration of ineligibility does not affect a member's rights in the SDR Department or its nonfinancial relations with the Fund.

The Executive Board decided in 1985 that the Fund will not negotiate or approve either a stand-by or an extended arrangement for a member in arrears to the Fund, and the member may not make purchases except in the reserve tranche. 11/ Similarly, in 1986 it decided that a member in such arrears cannot use the resources of the Structural Adjustment Facility within the Special Disbursement Account. 12/ Discussions may continue with the member on other aspects of relations with the Fund, such as Article IV consultations or the verification of performance criteria, and particularly on the steps the member is taking to settle its obligations to the Fund in a timely fashion. In the case of the SAF, discussions of the PFP may continue. 13/ Bridging arrangements with official creditors or commercial banks to eliminate the arrears have in several instances enabled discussion on use of resources to proceed.

Under the provisions of Article V, Section 7(g) repurchase obligations in the General Resources Account can be postponed within the outside limit of the installment schedule established under the arrangement by a decision of the Executive Board. Postponement of repurchase obligations beyond the repurchase period is possible only if discharge on the due date would result in exceptional hardship for the member and if the longer period is consistent with the temporary use of the general resources of the Fund. Postponement of repurchase obligations related to purchases made in the General Resources Account after the Second Amendment of the Articles has been recommended to the Executive Board on three occasions only and for brief periods, and within the maximum period specified in the arrangement. 14/ In 1984, the Executive Board concluded that there was a "very strong sentiment against the idea that the Fund should match the rescheduling operations of the Paris Club of any other group." 15/ Facilities other than the General Accounts (Trust Fund and SAF) contain provisions on postponement of repayments. The Fund's Articles provide no authority to the Executive Board for postponement of payments of charges.

References

1/ Executive Board Decision No. 3153-(70/95), October 26, 1970, Selected Decisions of the International Monetary Fund, Twelfth Issue, p. 283.

2/ "Review of Fund Policies and Procedures on Payments Arrears" (EBS/80/190, 8/27/80).

3/ "External Payments Arrears of Fund Members, 1980-81" (EBS/82/57, 3/31/82).

"External Payments Arrears of Fund Members, 1981-82" (EBS/83/12, 1/12/83).

"External Payments Arrears of Fund Members, 1982-83" (EBS/84/155, 7/30/84).

"External Payments Arrears of Fund Members, 1985-86" (EBS/86/261, and Supp. 1, 11/24/86).

4/ Executive Board Decision No. 6056-(79/38), March 2, 1979, Selected Decisions of the International Monetary Fund, Twelfth Issue, p. 26.

5/ EBM/84/155 (10/24/84); on the basis of staff report, "Approval in Principle of Fund Arrangements" (SM/84/217, 9/25/84).

6/ Ibid, p. 11, para. 1.

7/ "Recent Experience with Multilateral Official Debt Restructuring," (SM/86/194, 8/7/86).

8/ "Implementation of the Debt Strategy--Current Issues," (EBS/87/38, 2/20/87).

9/ "Completion of Commercial Bank Financing Packages--The Deposit Account Approach," memorandum to U.S. authorities (secret), January 6, 1987

10/ "Overdue Financial Obligations to the Fund--Ineligibility to Use the General Resources and Subsequent Actions by the Fund--Legal Aspects," (SM/86/102, 5/1.4/86).

11/ Executive Board Decision No. 7908-(85/26), February 20, 1985, Selected Decisions of the International Monetary Fund, Twelfth Issue, pp. 75 and 76.

12/ Regulations for the Administration of the Facility, paragraph 6(2) in the Annex to Decision No. 8238-(86/56)SAF, March 26, 1986, Selected Decisions of the International Monetary Fund, Twelfth Issue, p. 136.

13/ "Structural Adjustment Facility (SAF)--Review of Experience," (EBS/87/46, and Supp. 1, 2/27/87).

14/ "Repurchase Obligations--Postponement (Article V, Section 7(g), paper for the information of the Executive Board, (draft), 5/28/87.

15/ Chairman's Summing Up at EBM/84/55 (4/5/84), Buff 84/56 (4/12/84), P. 3.



Office Memorandum

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*Managing Director
I agree with the
attached but hold it
up for your final
review*

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TO: The Acting Managing Director
FROM: C. David Finch ^{CAF} and François Gianviti ^{F.G.}
SUBJECT: Fund Jurisdiction in Situations of Incomplete
Commercial Bank Financing Packages

December 30, 1986

*DOE
Dec. 31, 1986
OK*

In accordance with the discussion in our December 23 meeting with you, attached is a revised draft note on this subject responding to the request by the U.S. authorities.

The new first two paragraphs contain a reference to that request, and the various disclaimers. It was felt useful to integrate these into the paper itself, and to have a pro forma transmittal note. In view of the disclaimers, where the note had overtones of a "proposal," we have redrafted accordingly. On page 3 the discussion has been broadened to comprehend refinancing and new money, and there is a specific reference to the effects on banks' sharing provisions. There is also reference to the fact that the local currency deposits may be sold or swapped. The other main changes are to paragraph 6 to introduce some further flexibility into the description of approval policies, and to the first sentence of paragraph 7 to indicate that there may well be suits against agent banks.

If you wish, we could brief and pass the note to Mr. Dallara, or you may wish to do so yourself. In any event, we would propose that the authorities be requested to notify us beforehand should they wish to cite or to circulate the note outside of U.S. official circles, so that appropriate arrangements might be made for informing the relevant Executive Directors.

*I'll talk to
Mr. Dallara
if you wish
I agree*

Attachment

cc: The Managing Director (o/r)
Mr. Beza
Mr. Brown

1986 DEC 30 PM 3 15

DEPUTY MANAGING DIRECTOR

WITHDRAWAL NOTICE**PROJECT**

Project number 2004-010
Project name CF/Safe Files
Project tab number 409
Project box number 6

DOCUMENT

Series / File Arrears (36542)
Original box / file No 2 / 3
Date 1986-12-16
Type Paper
From C. D. Finch and F. Gianviti
To MD and DMD
Subject / Title Memo subject Fund Jurisdiction in Situations of Incomplete Commercial Bank
Refinancing; And DRAFT of paper Completion of Commercial Bank Refinancing -- the Deposit
Account Approach.
Number of pages 16
Classification SECRET
Authority Legal Department
Policy Development and Review Department

COMMENTS

Memo Dec. 16, 1986 and Paper (Draft) 12/16/1986

**THIS DOCUMENT IS IN THE COURSE OF A SYSTEMATIC
PUBLIC DISCLOSURE REVIEW PROCESS**

Entered by ccochrane

Entered on 2008-06-12

WITHDRAWAL NOTICE**PROJECT**

Project number 2006-001
Project name WHDAI/Western Hemisphere Immediate Office
Project tab number 533
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DOCUMENT

Series / File Arrears (36542)
Original box / file No 2 / 3
Date 1987-01-06
Type Memo
From Francois Gianviti
To Michael Bradfield
Subject / Title Completion of Commercial Packages - the Deposit Account Approach
Number of pages 11
Classification SECRET
Authority Legal Department

COMMENTS

Michael Bradfield, General Council Board of Governors of the Federal Reserve System

**THIS DOCUMENT IS IN THE COURSE OF A SYSTEMATIC
PUBLIC DISCLOSURE REVIEW PROCESS**

Entered by jdurkin

Entered on 2006-11-28

EBS/86/261
Supplement 1

CONFIDENTIAL

December 9, 1986

To: Members of the Executive Board
From: The Secretary
Subject: External Payments Arrears of Fund Members, 1985-86

The attached supplement is circulated for the information of the Executive Directors prior to the Board discussion on Brazil scheduled for tomorrow, Wednesday, December 10, 1986.

Ms. Jul (ext. 8524) is available to answer technical or factual questions relating to this paper.

Att: (1)

INTERNATIONAL MONETARY FUND

External Payments Arrears of
Fund Members, 1985-86 1/

Prepared by the Exchange and Trade Relations Department

(In consultation with other departments)

Approved by C. David Finch

December 9, 1986

For those countries for which the information is available (Table 1), estimated arrears to official creditors, excluding the Fund, amounted to just under one half of the total external payments arrears of the Fund membership in both 1985 and 1986. About two thirds of the arrears to official creditors were concentrated in four countries in 1985 and 1986 (Brazil, Egypt, Nigeria, and Sudan). In Brazil and Egypt, all arrears were with respect to official creditors. Arrears to other than official creditors were even more concentrated, with more than two thirds being accounted for in 1986 by three countries (Nigeria, Peru and South Africa).

Eleven countries have approached their official creditors for a rescheduling or are expected to do so in early 1987 (Argentina, Brazil, Egypt, Guatemala, Jamaica, Mozambique, Nigeria, Poland, Somalia, Zaïre, and Zambia). These eleven countries represent about three fourths of arrears to official creditors. Negotiations with other creditors were reported for six countries (Bolivia, Morocco, Mozambique, Nigeria, Venezuela, and Zambia) that represented about one third of these arrears outstanding for which estimates are available.

1/ This supplement provides additional background material for "External Payments Arrears of Fund Members, 1985-86" (EBS/86/261, 11/24/86). It also updates the data presented in Appendix Table I of EBS/86/261 (see second table attached).

Table 1. External Payments Arrears of Fund Members,
by Type of Creditor

(In millions of SDRs; end of period)

Member Country	1985 1/			1986 1/		
	Official Creditors	Other Creditors 2/	Total	Official Creditors	Other Creditors 2/	Total
Antigua and Barbuda	...	...	22	...	...	26
Argentina	275	1,289	1,564	914	734	1,648
Benin	...	...	156	...	...	169
Bolivia	173	749	922	46	785	831
Brazil	2,299	—	2,299	3,200	—	3,200
Burkina Faso	...	...	64	...	...	...
Central African Republic	...	...	4	—	—	—
Chad	...	...	55	...	...	58
Comoros	...	...	4	...	...	...
Congo	...	...	230	79	22	101
Costa Rica	5	25	30	...	...	109
Dominican Republic	7	87	94	140	41	181
Egypt	3,371	—	3,371	3,946	—	3,946
El Salvador	—	87	87	—	29	29
Equatorial Guinea	...	...	3	...	...	4
The Gambia	...	...	54	...	...	79
Ghana	19	140	159	5	174	179
Grenada	3	—	3	5	—	5
Guatemala	73	460	533	87	421	508
Guinea	...	...	346	...	...	191
Guinea-Bissau	...	...	26	...	...	...
Guyana	...	...	643	...	...	657
Haiti	—	11	11	—	12	12
Honduras	—	188	188	—	172	172
Jamaica	65	36	101	288	21	309
Liberia	84	54	138	137	110	247
Madagascar	...	...	73	...	...	...
Mali	...	...	4	—	—	—
Mauritius	...	...	119	—	—	—
Mexico	—	—	—	—	—	...
Morocco	60	164	224	76	380	456
Mozambique	650	188	838	1,028	297	1,325
Nicaragua	...	...	633	...	...	...
Nigeria	1,918	1,684	3,602	3,007	2,369	5,376
Paraguay	44	88	132	63	38	101
Peru	512	2,326	2,838	824	3,815	4,639
Poland	620	20	640	723	41	764
Romania	—	—	—	58	—	58
St. Lucia	...	...	1	...	...	1
Sao Tomé & Príncipe	...	...	11	...	...	9
Senegal	...	...	26	—	—	—
Sierra Leone	77	199	276	16	225	241
Somalia	42	—	42	65	—	65
South Africa	—	6,094	6,094	—	7,850	7,850
Sudan	1,279	590	1,869	1,396	566	1,962
Suriname	...	...	61	—	—	—
Tanzania	...	...	581	...	...	611
Uganda	64	8	72	...	...	...
Venezuela	591	2,144	2,735	536	1,659	2,195
Viet Nam	546	126	672	595	137	732
Western Samoa	...	...	1	...	...	1
Yugoslavia	...	...	1,477	—	—	—
Zaire	65	36	101	40	19	59
Zambia	495	586	1,081	120	571	691

Source: National authorities and Fund Staff Estimates.

1/ Most recent data available

2/ Including officially guaranteed private sector obligations in arrears

Table 2. External Payments Arrears Outstanding, 1976-1986 1/
(In millions of SDRs; end of period)

	1976	1977	1978	1979	1980	1981	1982	1983	1984	1985 2/	1986 2/	1985 Arrears as percentage of 1984 Imports
Afghanistan					x	x	x	x	x	x	x	...
Antigua and Barbuda				1	2	3	8	14	19	22	26	19
Argentina*							6,590	13,105	19,674	1,564	1,648	34
Belize*								5	6			
Benin	...			22			11	49	89	156	169	60
Bolivia				12	126	104	228	438	727	922	831	200
Brazil								2,235		2,299	3,200	19
Burkina Faso						13	25	27	37	64	...	33
Central African Republic*	35	39	8	42	63	43	45	28	12	4		3
Chad	9	9	5	4	9	37	42	48	51	55	58	46
Comoros						1	1	2	3	4	...	13
Congo	4	4	23	31	14	34	30	62	97	230	101	36
Costa Rica*					234	565	1,007	38	219	30	169	3
Côte d'Ivoire*								174	53			
Dominican Republic*	11			33	117	272	396	211	501	94	181	6
Ecuador*							191	97	60			
Egypt	312	862							...	3,371	3,946	29
El Salvador					45	80	80	53	99	87	29	10
Equatorial Guinea*						2	9	20	43	29	1	81
Gabon		430	339								...	
The Gambia					9	20	12	43	52	54	79	57
Ghana*	192	201	393	324	269	440	524	420	237	159	179	26
Grenada	x	x	2	1				1	2	3	5	5
Guatemala							261	273	500	533	508	46
Guinea	90	119	151	90	87	123	177	225	287	346	191	87
Guinea-Bissau	7	7	8	5	2	5	9	14	18	26	...	43
Guyana		27	17	22	34	101	220	391	546	643	657	300
Haiti						18	19	8	2	11	12	4
Honduras						12	52	99	172	188	172	22
Jamaica*		22	48	42	89	39		86	112	101	309	9
Liberia*						10	2	14	22	138	247	34
Madagascar*	5	7	11	13	175	103	213	96	81	73	...	20
Mali*		11	18	27	38	54	31	9		4		2
Mauritania*	x	9	23	15	28	20	37	55	105	119		38
Mexico							1,240	267			...	
Morocco*							253		127	224	456	6
Mozambique								285	751	838	1,325	155
Nicaragua			58	363	621	453	393	489	641	633	...	87
Nigeria							1,948	4,360	4,903	3,907	5,376	49
Paraguay								86	94	132	101	12
Peru	...	...	115					21	1,420	2,838	4,639	126
Philippines*								1,565	2,744			17
Poland	...	...	...	...	...	...	...	...	...	640	764	
Romania						981	352				58	
St. Lucia								x	1	1	...	1
Sao Tomé & Príncipe						9	8	9	6	11	9	39
Senegal*					7	12				26		3
Sierra Leone	4	15	25	39	55	113	200	240	236	270	208	191
Somalia					13	35	40	50	79	120	42	10
South Africa										6,094	7,850	28
Sudan	241	572	597	878	848	1,293	1,428	1,121	963	1,869	1,962	156
Suriname									44	61		17
Tanzania	4	2	55	126	254	294	364	516	709	581	611	67
Togo*		8	34	21	22	64	162	1	4			
Turkey	202	1,710	1,523	1,769	1,266	275						
Uganda	29	21	63	68	172	130	113	75	60	72	...	15
Venezuela							748	3,916	4,518	2,735	2,195	22
Viet Nam						32	227	406	639	672	732	37
Western Samoa					1	9	13	3	2	1	1	2
Yugoslavia*							295			1,477		15
Zaire*	385	671	950	1,118	450	530	848	372	181	101	59	15
Zambia*	223	394	496	351	461	500	725	597	568	1,081	691	153
Total	1,753	5,140	4,962	5,430	5,553	6,835	19,584	32,748	42,557	35,635	...	...

Memorandum item:

Aggregate amount resched- uled in each year 3/	334	457	2,222	4,462	3,769	1,893	5,525	67,585	37,491	118,517	...
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Sources: National authorities and Fund staff estimates.

1/ The table shows data on countries known to have had external payments arrears in any year during the period 1976-1986 or other dates indicated in the footnotes. Defaults, i.e., payments arrears incurred by governments participating in common central bank arrangements (Bank of Central African States (BEAC), Central Bank of West African States (BOEAO), and Eastern Caribbean Central Bank (ECCB)) resulting from the government's inability to obtain domestic currency with which to purchase needed foreign exchange from the common central bank, as well as those incurred by the government or a government entity whose financial operations form part of the budgetary process, are included in these figures. In the former case, since it is not possible to distinguish between domestic and external arrears, total arrears are shown.

2/ Most recent estimates available; where end-year data are not available, data at the end of the most recent period are used to arrive at totals.

3/ Amounts are with respect to creditors in Fund member countries and include rescheduling of arrears and service obligations not yet due.

Symbols: * Financial program supported by use of Fund resources in effect in December 1985 (including arrangements under which purchases have been suspended). x Arrears less than SDR 0.5 million.



Office Memorandum

TO: Heads of Departments, AFR, ASD
EUR, MED, SEC, WHD

December 5, 1986

FROM: C. David Finch *CD*

As indicated in the attached memorandum, your comments to Ms. Jul (ext. 8524) by noon, Monday, December 8, including any further available data, would be very much appreciated.

Attachment



Office Memorandum

TO: The Managing Director
The Deputy Managing Director

December 5, 1986

FROM: C. David Finch *CD*

SUBJECT: External Payments Arrears of Fund Members, 1985/86

In response to a request by Mr. Kafka made to the Deputy Managing Director, and our discussions with Mr. Kafka this week, we have prepared the attached supplement to the paper on this subject (EBS/86/261) that was issued to the Executive Board on November 24.

The short supplement, which is for your approval, was requested by Mr. Kafka for issuance prior to the Brazil Board meeting scheduled for Wednesday, December 10. The data therein disaggregating members' arrears by official and other creditors has in most instances been prepared with the assistance of area departments. In order to meet the timetable as requested we are circulating the draft simultaneously to departments for their comments, and would appreciate your reaction as soon as possible.

Attachment

cc: Heads of Departments, AFR, ASD, EUR, MED, SEC, WHD
Mr. Brown

INTERNATIONAL MONETARY FUND

External Payments Arrears of
Fund Members, 1985-86 ^{1/}

Prepared by the Exchange and Trade Relations Department

(In consultation with other departments)

Approved by C. David Finch

December , 1986

For those countries for which the information is available (Table 1), estimated arrears to official creditors, excluding the Fund, amounted to just under one half of the total external payments arrears of the Fund membership in both 1985 and 1986. About two-thirds of the arrears to official creditors were concentrated in four countries in 1985 and 1986 (Brazil, Egypt, Mozambique, and Sudan). In Brazil and Egypt, all arrears were with respect to official creditors. Arrears to other than official creditors were even more concentrated, with two thirds being accounted for in 1986 by two countries (Peru and South Africa).

Negotiations with official creditors were reported to be underway, or expected to commence in early 1987, for nine countries representing almost two-thirds of the total arrears outstanding to those creditors (Brazil, Egypt, Guatemala, Jamaica, Mozambique, Poland, Somalia, Zaïre, and Zambia). Negotiations with other creditors were reported for four countries (Bolivia, Morocco, Mozambique, and Zambia) that represented just over one-third of these arrears outstanding for which estimates are available.

^{1/} This supplement provides additional background material for "External Payments Arrears of Fund Members, 1985-86" (EBS/86/261, 11/24/86). It also updates the data presented in Appendix Table I of EBS/86/261 (see second table attached).

tbepaamj (12/4/86)

Table 1. External Payments Arrears of Fund Members,
by Type of Creditor

(In millions of SDRs; end of period)

Member Country	1985 1/			1986 1/		
	Official Creditors	Other Creditors 2/	Total	Official Creditors	Other Creditors 2/	Total
Antigua and Barbuda			21			
Argentina	275	1,289	1,564	175	734	909
Benin			156			169
Bolivia	173	749	922	195	785	980
Brazil	2,299	--	2,299	3,200	--	3,200
Burkina Faso			64			
Central African Republic			4	--	--	--
Chad			55			60
comoros			4			
Congo			212			175
Costa Rica	5	25	30	...	...	109
Dominican Republic	7	87	94	140	41	181
Egypt	3,371	--	3,371	3,946	--	3,946
El Salvador	--	87	87	--	29	29
Equatorial Guinea			29			1
The Gambia			54			79
Ghana	19	140	159	5	174	179
Grenada			1			
Guatemala	73	460	533	87	421	508
Guinea			346			191
Guinea-Bissau	...	...	26	...	...	...
Guyana	...	...	643	...	...	657
Haiti			11			
Honduras	--	188	188	--	172	172
Jamaica	65	36	101	288	21	309
Liberia	84	54	138	137	110	247
Madagascar			73	...		
Mali			4	--	--	--
Mexico	--	--	--			
Morocco	60	164	224	76	380	456
Mozambique	650	188	838	1,028	297	1,325
Nicaragua	...	...	633	...	...	...
Nigeria			3,861			
Paraguay	44	88	132	63	38	101
Peru	512	2,326	2,838	824	3,815	4,639
Poland	620	20	640	745	19	764
Romania	--	--	--			85
St. Lucia			1			
Sao Tomé & Principe			11			9
Senegal			26	--	--	--
Sierra Leone	74	198	272	96	198	294
Somalia	42	--	42	65	--	65
South Africa	--	6,094	6,094	--	7,850	7,850
Sudan	1,488	590	2,078	1,691	566	2,257
Suriname			61	--	--	--
Tanzania	...	...	581	...	...	611
Uganda	64	8	72	...	...	...
Venezuela			4,827			4,864
Viet Nam	515	68	583	757	101	858
Western Samoa			1			1
Yugoslavia	...	...	1,477	...	...	...
Zaire	65	36	101	40	19	59
Zambia	495	586	1,081	120	571	691

Source: National Authorities and Fund Staff Estimates.

1/ Most recent data available

2/ Including officially guaranteed private sector obligations in arrears

Table 2. External Payments Arrears Outstanding, 1976-1986 1/
(In millions of SDRs; end of period)

	1976	1977	1978	1979	1980	1981	1982	1983	1984	1985 2/	1986 2/	1985 Arrears as percentage of 1984 Imports
Afghanistan					x	x	x	x	x	x	x	...
Antigua and Barbuda	—	—	—	1	2	3	8	14	19	21	...	14
Argentina*	—	—	—	—	—	—	6,590	13,105	19,674	1,564	909	34
Belize*	—	—	—	—	—	—	—	5	6	—	—	—
Benin	...	—	—	22	—	—	11	49	89	156	169	64
Bolivia	—	—	—	12	126	104	228	438	727	922	980	200
Brazil	—	—	—	—	—	—	—	2,235	—	2,299	3,250	19
Burkina Faso	—	—	—	—	—	13	25	27	37	64	...	33
Central African Republic*	35	39	8	42	63	43	45	28	12	4	—	3
Chad	9	9	5	4	9	37	42	48	51	55	60	46
Comoros	—	—	—	—	—	1	—	2	3	4	...	13
Congo	4	4	23	31	14	34	30	62	97	212	175	33
Costa Rica*	—	—	—	—	234	565	1,007	38	219	30	109	3
Côte d'Ivoire*	—	—	—	—	—	—	—	174	53	—	—	—
Dominican Republic*	11	—	—	17	37	54	165	137	501	94	181	6
Ecuador*	—	—	—	—	—	—	191	97	60	—	—	—
Egypt	312	862	—	—	—	—	—	—	...	3,371	3,946	29
El Salvador	—	—	—	—	45	80	80	53	99	87	29	10
Equatorial Guinea*	—	—	—	—	—	2	9	20	43	29	1	81
Gabon	—	430	339	—	—	—	—	—	—	—	...	—
The Gambia	—	—	—	—	9	20	12	43	52	54	79	57
Ghana*	192	201	393	324	269	440	524	420	237	159	179	26
Grenada	x	x	2	1	—	—	—	1	1	1	...	2
Guatemala	—	—	—	—	—	—	261	273	500	533	508	46
Guinea	90	119	151	90	87	123	177	225	287	346	191	87
Guinea-Bissau	7	7	8	5	2	5	9	14	18	26	...	43
Guyana	—	27	17	22	34	101	220	391	546	643	657	300
Haiti	—	—	—	—	—	18	19	9	3	11	...	3
Honduras	—	—	—	—	—	12	52	99	172	188	172	22
Jamaica*	—	22	48	42	89	39	—	86	112	101	309	9
Liberia*	—	—	—	—	—	10	2	14	22	138	247	34
Madagascar*	5	7	11	13	175	103	213	96	81	73	...	20
Mali*	—	11	18	27	38	54	31	9	—	4	—	2
Mauritania*	x	9	23	15	28	20	37	59	107	—	—	—
Mexico	—	—	—	—	—	—	1,240	267	—	—	...	—
Morocco*	—	—	—	—	—	—	253	—	127	224	456	6
Mozambique	—	—	—	—	—	—	—	285	751	838	1,325	155
Nicaragua	—	—	58	363	621	453	393	489	641	633	...	87
Nigeria	—	—	—	—	—	—	1,948	4,360	4,903	3,861	...	48
Paraguay	—	—	—	—	—	—	—	86	94	132	101	12
Peru	...	...	115	—	—	—	—	21	1,420	2,838	4,639	126
Philippines*	—	—	—	—	—	—	—	1,565	2,744	—	—	—
Poland	...	...	...	...	...	...	...	...	...	640	764	—
Romania	—	—	—	—	—	981	352	—	—	—	85	—
St. Lucia	—	—	—	—	—	—	—	x	1	1	...	1
Sao Tomé & Príncipe	—	—	—	—	—	9	8	9	6	11	9	39
Senegal*	—	—	—	—	7	12	—	—	—	26	—	3
Sierra Leone	4	15	25	39	55	113	200	240	236	272	294	192
Somalia	—	—	—	13	35	40	50	79	120	42	65	10
South Africa	—	—	—	—	—	—	—	—	—	6,094	7,850	28
Sudan	241	572	597	878	848	1,293	1,428	1,121	963	2,078	2,257	156
Suriname	—	—	—	—	—	—	—	—	44	61	—	17
Tanzania	4	2	55	126	254	294	364	516	709	581	611	67
Togo*	—	8	34	21	22	64	162	1	4	—	—	—
Turkey	202	1,710	1,523	1,769	1,266	275	—	—	—	—	—	—
Uganda	29	21	63	68	172	130	113	75	60	72	...	15
Venezuela	—	—	—	—	—	—	748	3,916	4,489	4,827	4,864	38
Viet Nam	—	—	—	—	—	33	224	380	582	583	858	32
Western Samoa	—	—	—	—	1	9	13	3	2	1	1	2
Yugoslavia*	—	—	—	—	—	—	295	—	—	1,477	...	15
Zaire*	385	671	950	1,118	450	530	848	372	181	101	59	15
Zambia*	223	394	496	351	461	500	725	597	568	1,081	691	153
Total	1,753	5,140	4,962	5,414	5,453	6,617	19,353	32,653	42,473	37,663	...	...

Memorandum item:

Aggregate amount resched-
uled in each year 3/ 334 457 2,222 4,462 3,769 1,893 5,525 67,585 37,491 118,517 ...

Sources: National authorities and Fund staff estimates.

1/ The table shows data on countries known to have had external payments arrears in any year during the period 1976-1986 or other dates indicated in the footnotes. Defaults, i.e., payments arrears incurred by governments participating in common central bank arrangements (Bank of Central African States (BEAC), Central Bank of West African States (BCEAO), and Eastern Caribbean Central Bank (ECCB)) resulting from the government's inability to obtain domestic currency with which to purchase needed foreign exchange from the common central bank, as well as those incurred by the government or a government entity whose financial operations form part of the budgetary process, are included in these figures. In the former case, since it is not possible to distinguish between domestic and external arrears, total arrears are shown.

2/ Most recent estimates available; where end-year data are not available, data at the end of the most recent period are used to arrive at totals.

3/ Amounts are with respect to Fund member creditors and include rescheduling of arrears and service obligations not yet due.

Symbols: * Financial program supported by use of Fund resources in effect in December 1985 (including arrangements under which purchases have been suspended). x Arrears less than SDR 0.5 million.

DOCUMENT OF INTERNATIONAL MONETARY FUND AND NOT FOR PUBLIC USE

EBS/86/261

CONFIDENTIAL

November 24, 1986

To: Members of the Executive Board
From: The Secretary
Subject: External Payments Arrears of Fund Members, 1985-86

There is attached for the information of the Executive Directors a paper on the external payments arrears of Fund members for the period 1985-86.

Mr. Quirk (ext. 8520) is available to answer technical or factual questions relating to this paper.

Att: (1)

INTERNATIONAL MONETARY FUND

External Payments Arrears of Fund Members, 1985-86

Prepared by the Exchange and Trade
Relations Department

(In consultation with other departments)

Approved by C. David Finch

November 21, 1986

I. Introduction

This paper is the fourth in a series reviewing developments relating to external payments arrears of Fund members and the implementation of Fund policies in assisting members to eliminate this particular form of exchange restriction. 1/ It presents updated information that is available for the period 1985-86, and reviews the treatment of payments arrears within stand-by and extended arrangements in effect as of mid-1986, and within the context of Fund jurisdiction under Articles VIII and XIV. The paper discusses the relative emphasis accorded to cash payments and the rescheduling of external obligations in setting targets for reducing arrears, and reviews other criteria relating to the elimination or re-emergence of arrears in the context of the use of Fund resources.

II. Developments in the Arrears Situation

In contrast to the rapid and sustained build-up of members' external payments arrears in recent years, 1985 witnessed for the first time a reduction in members' aggregate arrears to SDR 36 billion at end-year, from SDR 42 billion at end-1984 (Appendix Table 1). 2/ At this

1/ See "External Payments Arrears of Fund Members, 1980-81" (EBS/82/57, 3/31/82), "External Payments Arrears of Fund Members, 1981-82" (EBS/83/12, 1/12/83), and "External Payments Arrears of Fund Members, 1982-83" (EBS/84/155, 7/26/84).

2/ The Fund's data on members' payments arrears comprehends arrears which have been caused by exchange restrictions on current payments or transfers as well as arrears on financial obligations of which the obligor is the government or a resident in the country in question and which are overdue for balance of payments or fiscal reasons. Payments arrears evidence an exchange restriction under Article VIII, Section 2(a) and Article XIV, Section 2 when the authorities of a country are responsible for undue delays in approving applications or in meeting bona fide requests for foreign exchange for current international transactions, as defined in Article XXX (d). When a government or a government entity whose financial operations form part of the budgetary process fails to meet an external payments obligation due to a lack of

level, the arrears were equivalent to just over 4 percent of non-oil developing countries' external debt. Several factors can be identified for the departure in 1985 from the rising trend of Fund members' external payments arrears. 1/ First, in order to strengthen their balance of payments positions, members in many instances implemented adjustment programs supported by the Fund that incorporated a reduction of external arrears through cash payments. Cash payments against arrears are estimated to have risen from SDR 2 billion in 1984 to SDR 6 billion in 1985. Second, and also related to the adoption of adjustment measures, the total amount of external obligations rescheduled or refinanced rose threefold to SDR 119 billion in 1985 from SDR 37 billion in 1984 (SDR 68 billion in 1983). Of the total rescheduling of members' external payments obligations in 1985, SDR 18 billion was of obligations already in arrears, compared to SDR 3 billion in 1984. 2/

On an individual country basis, the largest absolute change in outstanding arrears from end-1984 to end-1985 was the SDR 18 billion reduction in Argentina, of which one quarter was attributable to cash payments. On the other hand, in response to a withdrawal of short-term credit lines by some U.S. banks, South Africa imposed a moratorium on certain foreign debt repayments falling due, leading to arrears of SDR 6 billion by end-1985. Other major developments included the elimination of arrears by the Philippines in 1985 from a peak of SDR 2.7 billion in 1984, and the reincurrence of arrears by Brazil. Nearly one half of the total stock of arrears outstanding at end-1985 (SDR 36.2 billion) were accounted for by five countries--South Africa,

2/ (cont'd from p.1) domestic currency, the resulting arrears are considered to be defaults rather than payments arrears that evidence exchange restrictions. Similarly, payments arrears incurred by member governments of a common central bank are treated as defaults when they are due to the government's inability to obtain domestic currency with which to purchase needed foreign exchange from the common central bank. Although the above distinction is relevant for the purposes of Articles VIII and XIV, in the context of the Fund's policies on the use of its resources, defaults and other forms of arrears involving current and capital payments are viewed as having the same broad macroeconomic character and consequences, and are therefore treated in the same manner.

1/ Partial data that are the most recent available for 1986 indicate that this reduction may not have continued (Appendix Table 1). A striking feature of the experience with external payments arrears in recent years has also been the continued increase in overdue financial obligations to the Fund. The outstanding amount at the end of 1983 was SDR 60.3 million, which rose to SDR 668.6 million by end-March 1986. For detailed information, see EBS/86/98 (April 28, 1986), "Overdue Financial Obligations to the Fund"--Six-Monthly Report.

2/ By rescheduling of arrears is meant the establishment of new contractual arrangements for external arrears with new maturity profiles. Temporary postponements and moratoria are not regarded by the Fund as eliminating the arrears (EBS/83/12, 1/12/83, page 12).

SDR 6.1 billion; Nigeria, SDR 3.9 billion; 1/ Egypt, SDR 3.2 billion; Peru, SDR 2.6 billion; and Brazil, SDR 2.1 billion.

In contrast to the reduction in aggregate amounts, the number of Fund members with external payments arrears at end-1985 was virtually unchanged at 52 members (including a new member, Poland). As noted in earlier papers in this series, once incurred, arrears have proven difficult to eradicate. Only 10 out of the 62 Fund members incurring payments arrears at some point during 1976-85 have managed to eliminate them. Only 9 other countries registered a steady decline over several years, and over 30 countries have experienced almost continuously rising arrears. Moreover, four countries that had eliminated payments arrears in earlier years incurred new arrears in 1985 (Brazil, Mali, Senegal, and Yugoslavia), and South Africa incurred arrears for the first time in 1985.

Five countries eliminated payments arrears in 1985 (Belize, Côte d'Ivoire, Mauritania, Philippines, and Togo). Of those five countries, three (Belize, Mauritania, and the Philippines) settled their arrears through a combination of reschedulings and cash payments (Appendix Table 2), whereas two (Côte d'Ivoire and Togo) settled their arrears through cash payments only. Another 15 countries reduced their payments arrears in 1985. Of these, 8 countries for whom data is available used a combination of reschedulings and cash payments (Argentina, Central African Republic, Costa Rica, Dominican Republic, Equatorial Guinea, Somalia, Venezuela, and Western Samoa), while three countries (Ghana, Madagascar, and Zaire) reduced their arrears through cash payments alone. However, of these latter instances, only in Ghana was the cash payment significant, representing about one quarter of arrears outstanding. The mix of rescheduling and cash payments has largely reflected the extent and duration of the arrears problem. Where international reserves have been already severely eroded, or the arrears have been largely a result of maturity "bunching," rescheduling has tended to be the predominant method.

Arrears are one manifestation of a broader phenomenon of deviations from scheduled external payments obligations. The extent of such overall deferrals of payments obligations can be measured by aggregating arrears and outstanding amounts rescheduled, net of estimated repayments in respect of rescheduled amounts (the sum of lines (a) and (c) in Appendix Table 3). Despite a smaller increase in 1984 than those in previous years, overall deferrals of external contractual obligations

1/ Nigeria has recently adopted an economic program and reached agreement for restructuring arrangements which are aimed at eliminating external arrears by end-1986.

almost doubled in 1985, to US\$236 billion, ^{1/} or 28 percent of non-oil developing countries' debt at end-1985--up from 16 percent at end-1984 and 14 percent at end-1983 (Chart 1). Servicing equivalent to over one quarter of outstanding non-oil developing country debt had therefore departed from original contractual arrangements by end-1985.

The maintenance of external payments arrears and the ensuing disorderliness in financial flows creates serious difficulties for debtor countries. The resulting loss of creditworthiness not only restricts debtor countries' access to normal external financing but also increases the cost of international credit. Prompt elimination of external payments arrears in the context of a stabilization program and, where applicable, restructuring arrangements, is therefore crucial to restore the creditworthiness of the country so as to attract the new financial flows necessary to support renewed growth of domestic income and output and the debt servicing capacity of the country on a sustainable basis.

Information on payments arrears for 1984 and 1985 in terms of the type of payments categories involved (imports, invisibles, or the capital account) has been compiled for 27 countries (Appendix Table 4). At the end of 1985, arrears relating to payments for international trade in goods and services accounted for about one-half of total arrears for which the corresponding balance of payments categories are identified, up from one-third in 1984. As noted in the previous report, this type of arrears has not only impeded the normal flow of short-term trade finance, but has led some countries to favor relatively inefficient bilateral trade financing schemes, including countertrade arrangements.

III. Implementation of Fund Policies in Programs in Support of Use of Resources

1. Performance criteria

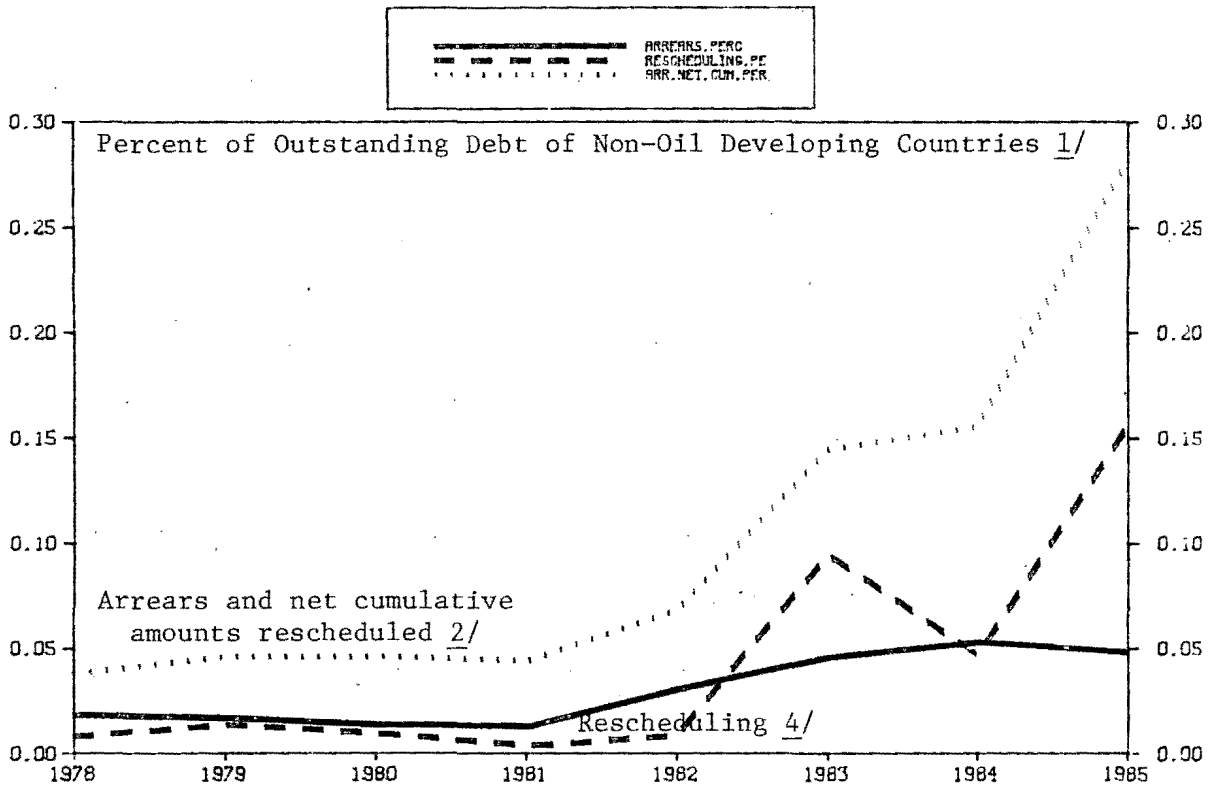
In accordance with the policies approved by the Executive Board on October 26, 1970, ^{2/} in approving requests for the use of its resources the Fund has continued to require that existing payments arrears be eliminated, or at least reduced, during the program period. External

^{1/} About three quarters of the end-1985 total was accounted for by the following 11 countries: Argentina US\$17 billion; Brazil US\$11 billion; Chile US\$10 billion; Ecuador US\$6 billion; Mexico US\$69 billion; Philippines US\$6 billion; Poland US\$19 billion; South Africa US\$6 billion; Turkey US\$5 billion; Venezuela US\$20 billion; and Yugoslavia US\$6 billion. With the exception of Poland, South Africa, and Turkey, all countries are classified by the Fund as heavily indebted. Mexico alone accounted for over one quarter of the total. Ecuador, Mexico and Venezuela have signed multi-year restructuring agreements in the last two years.

^{2/} Executive Board Decision No. 3153-(70/95).

Chart 1.

Payments Delayed and Deferred by Fund Members 1978-1985



Sources: World Bank, World Debt Tables 1983-84; OECD, External Debt of Developing Countries, 1984; IMF International Financial Statistics (various issues); and staff estimates.

1/ Public and publicly-guaranteed debt.

2/ Sum of arrears and cumulative rescheduled amounts, net of estimated payments in respect of rescheduled amounts (stocks as of end of the indicated year).

3/ From Appendix Table 1.

4/ Amounts rescheduled in each year (flows) are with respect to ODA countries and major private creditors (See Appendix Table 3).

payments arrears for the purposes of performance criteria in Fund programs may be defined as all overdue external financial obligations, including those not evidencing restrictions subject to Fund jurisdiction under Article VIII of the Articles of Agreement. Overdue obligations remaining after general agreements for their rescheduling or refinancing have been reached, pending completion of bilateral agreements, are not defined as external payments arrears for these purposes. Among the 21 members that had a stand-by arrangement ^{1/} in effect with the Fund as of June 30, 1986, 13 countries had external payments arrears at the time of program approval: Argentina, Bolivia, Central African Republic, Côte d'Ivoire, Equatorial Guinea, Guinea, Mali, Morocco, Philippines, Senegal, ^{2/} Somalia, Zaïre, and Zambia (Appendix Table 5).

a. Reduction and elimination of arrears as a performance criterion

In all countries with programs in effect in mid-1986, a specific performance criterion was included in the program for eliminating or reducing outstanding payments arrears during or by the end of the program period, in accordance with a quantified schedule.

It is often difficult to determine the level of external payments arrears at the time the program is formulated, and understandings under the adjustment program can be impaired if external arrears turn out to be greater than originally anticipated at the time the arrangement was formulated, or if new arrears are incurred during the program period. For these reasons, performance criteria other than for outright elimination of arrears have in practice specified amounts of arrears reductions in terms of flows, so that regardless of the initial level of arrears, observance is assessed through nominal reductions of arrears by at least the amount included in the authorities' statements or supporting documents submitted to the Executive Board.

In relation to the overall amount of arrears and the size of Fund drawings, provisions for reductions of arrears have varied in accordance with the members' individual positions. In 10 of the 13 instances, the programs incorporated targets or prior action for full elimination of the arrears within program period; in eight of these cases, the elimination was to occur within the first year of the program period. In two remaining instances (Guinea and Zaïre), the targets were for less than full elimination.

^{1/} There were no extended arrangements in effect as of June 30, 1986 for any country with external payments arrears. Argentina's and Equatorial Guinea's stand-by arrangements both expired on June 30, 1986, and the arrangement of the Philippines was cancelled effective June 9, 1986.

^{2/} In the case of Senegal, external payments arrears were incurred after the stand-by arrangement was approved by the Executive Board (in January 1985). Their elimination by the end of June 1986 became a performance criterion at the time of the third review of the stand-by arrangement.

As noted in the earlier reports on members' arrears, provisions for counterpart deposit requirements have been important in several instances in sterilizing liquidity for repayments, and also in providing more comprehensive information on arrears. The counterpart deposit requirement was not specifically incorporated as a performance criterion but was implemented in association with Fund-supported programs in four countries (Argentina, the Philippines, Zaïre, and Zambia). ^{1/} In other instances (Bolivia and Somalia), in which public sector arrears predominated, governments have maintained their own records and provided liquidity from fiscal sources and a counterpart deposit requirement has not been applied. In the third group comprised of members of a common central bank arrangement (Central African Republic, Côte d'Ivoire, Equatorial Guinea, Guinea, Mali, and Senegal), because the local currency is convertible, public sector arrears also predominated, and a counterpart deposit requirement was not applied.

b. Avoidance of new arrears as a performance criterion

When payments arrears involve restrictions on payments and transfers for current international transactions, the avoidance of new external payments arrears was stipulated in all stand-by arrangements in the form of the "standard" performance criterion to the effect that the member intends not to impose new or intensify existing exchange restrictions on payments and transfers for current international transactions. In instances where defaults (which are not considered evidence of exchange restrictions) have emerged in the past, stand-by arrangements may also include a specific performance criterion to the effect that no new external payments arrears on public and publicly guaranteed short-, medium-, or long-term debt service obligations or on publicly guaranteed commercial credit will be incurred. In the case of those 6 members which share a common currency and a common central bank and which had an arrangement from the Fund, ^{2/} a separate performance criterion relating to the accumulation of domestic arrears was included, in addition to the "standard" criterion. ^{3/} In three cases (Central African Republic, Equatorial Guinea, and Togo), the

^{1/} Morocco is presently in the process of introducing such a requirement.

^{2/} Central African Republic and Equatorial Guinea are both members of the Bank of Central African States (BEAC), and Côte d'Ivoire, Mali, Senegal and Togo are members of the Central Bank of West African States (BCEAO).

^{3/} As explained in footnote 1 on page 2, payments arrears incurred by governments participating in a common central bank are treated as defaults rather than arrears and do not evidence an exchange restriction under Article VIII when such overdue obligations arise owing to the lack of domestic currency with which to buy foreign exchange from the common central bank and not from an inability to meet financial obligations because of restrictions. Any such new arrears would not evidence exchange restrictions and therefore would not trigger the standard performance criterion, and therefore a special clause is included in the arrangements from the Fund.

avoidance of both external and domestic new arrears was a specific performance criterion.

c. Cash payments and rescheduling

The objective of reducing or eliminating outstanding payments arrears may be incorporated in the member's program supported by a stand-by arrangement in the form of rescheduling or refinancing assumptions, net cash payment targets, or a combination of both. In instances where the conclusion of a rescheduling negotiation multi-lateral creditor groups is imminent, stand-by arrangements have been approved on the expectation that agreement would be concluded successfully in the near future. In addition to the reduction or elimination of outstanding payments arrears through rescheduling, the program may specify a further reduction through net cash payments.

All 13 stand-by arrangements in effect as of June 30, 1986 with countries having payments arrears included reduction or elimination of payments arrears with rescheduling being assumed. In two of these cases (Somalia and Zaïre), stand-by arrangements were approved, in principle, until satisfactory arrangements were considered to have been made regarding the financing of uncovered balance of payments gap which included assumptions on reschedulings of payments arrears and/or debt service obligations falling due during the program period. In all the other arrangements the authorities had already initiated, or had the intention of initiating, contacts with creditors to reschedule external arrears. In the case of Côte d'Ivoire, agreements with commercial bank creditors were reached in principle prior to the approval of the stand-by arrangement. A meeting of official creditors to consider the request for debt rescheduling covering the program period was also expected to take place soon after the approval of the stand-by arrangement, and the resulting rescheduling was understood to cover the balance of payments gap. About half of the programs in effect as of June 30, 1986 incorporated as a separate performance criterion a reduction of payments arrears through net cash payments (Bolivia, Central African Republic, Equatorial Guinea, Guinea, Mali, Somalia, and Zaïre).

The proportion of members' external payments arrears settled through cash payments has varied in accordance with foreign exchange liquidity requirements as determined by anticipated cash needs for import payments and, more generally, by medium-term balance of payments projections. ^{1/} In cases where international reserve positions and medium-term balance of payments projections have been relatively strong or improving, cash payments against arrears have at times been significant in relation to total arrears reduction. In others, token cash payments have reflected the authorities' intention of meeting overdue obligations despite depleted reserve levels and a weak balance of payments outlook. In 1985, of the countries that eliminated or reduced

^{1/} The mix of cash payments against arrears has also reflected the settling of nonreschedulable arrears (e.g. to multilateral institutions or payments already rescheduled).

(in net terms) payments arrears, seven countries relied on cash payments alone and two countries on rescheduling alone (Ecuador and El Salvador) (Appendix Table 6). In those countries that relied on a mix of cash payments and rescheduling, the cash payments represented generally between one quarter and one half of the total.

2. Outcome under program targets

An important consideration in the setting of cash payment schedules has been to avoid placing strain on the member's foreign exchange liquidity that would eliminate the prospect of a reasonable build-up of international reserves and create the need for further rescheduling precipitated by adverse developments. Despite the incorporation of such margins of tolerance in programs, the performance criterion for arrears has not been met in several cases, and waivers or modifications to the programs have been granted where the basic aims of the program were still judged to be attainable. With regard to the programs in effect in mid-1986, seven countries out of the thirteen which had external payments arrears did not observe their respective performance criteria. In all but one country (Zambia), a waiver was granted or the performance criterion was modified. In only one case was the subsequent waiver or modification related solely to the performance criterion for external arrears (Somalia). In two cases, both the criteria related to external payments arrears and other performance criteria, were not observed (Argentina and Central African Republic) ^{1/} and in the three remaining cases, the performance criterion on external payments arrears was met but other criteria were not. Somalia was not able to observe the performance criterion on external payments arrears because there was a shortfall in expected donor assistance and foreign exchange receipts were lower than anticipated. Somalia's revised letter of intent specified that payments arrears would be reduced by less than the amount originally scheduled. The nonobservance of the performance criterion on external payments arrears in the Central African Republic resulted from a technical delay in their settlement. Only in Argentina were there substantial excesses with respect to external arrears (September and December 1985), despite a considerably more favorable than targeted performance in the overall balance of payments.

IV. Fund Jurisdiction

On the basis of the member's program, including the intention to reduce or eliminate external payments arrears in a nondiscriminatory manner to meet the other requisite conditions for the use of its resources, the Fund has approved on a temporary basis the exchange restrictions arising from external payments arrears (Appendix Table 7). The initial approval has been extended subsequently if the member has observed the performance criteria of its Fund-supported

^{1/} The first review of Zambia's current stand-by arrangement has not been completed due to substantial slippages in fiscal and balance of payments performance, including that related to external payments arrears.

economic program. Because of the linkage of the approval to performance under the program, and the pivotal role of the program in the multilateral rescheduling of arrears, the result has been that approval has been given as long as the member has been pursuing economic policies giving broad assurance of repayment.

The record of approval by the Executive Board of members' external payments arrears over the years 1984 to 1985 is summarized in Appendix Table 7. Where payments arrears gave rise to an exchange restriction, this was specified in all of the staff reports for the relevant Article IV consultations or requests for the use of Fund resources. The Executive Board's temporary approval of exchange restrictions evidenced by external payments arrears was granted in 21 cases in 1984 and in 10 cases in 1985. In each case, the member had a stand-by or extended arrangement in effect 1/ and approval was granted because the program contained an intention to reduce or eliminate external payments arrears. 2/ In 1985, approval was not proposed by the staff in 20 instances because no adequate program to reduce or eliminate the level of outstanding payments arrears existed. In four cases where there existed a stand-by arrangement, approval of external payments arrears restrictions was not granted by the Executive Board because new arrears were incurred in noncompliance with the arrangement (Mauritania, Costa Rica, Somalia, and Zambia). In the case of Mauritania, although the authorities eliminated outstanding arrears in 1985 as provided under the stand-by arrangement, new arrears emerged in the latter part of the year. In the case of Costa Rica, a small amount of payments arrears (less than US\$1 million) with respect to one private creditor was not approved by the Executive Board since the matter was in litigation and the maintenance of these arrears was not at the time assumed to be temporary. Instead of eliminating arrears as required under the terms of the program, Somalia accumulated new arrears in the first half of 1985 and failed to observe the end-June 1985 performance criterion. 3/

1/ In the case of Equatorial Guinea, exchange restrictions in the form of external payments arrears were approved on assurances from the authorities that such restrictions would be eased upon Equatorial Guinea's entrance into BEAC on January 1, 1985, and through a comprehensive adjustment program. Approval of Guinea-Bissau's exchange restrictions was based upon a program of economic adjustment supported by the Fund and on an intention to reschedule arrears by the end of 1984.

2/ As noted in the previous report, Peru was granted approval of its exchange restrictions, evidenced by arrears, that remained following a general agreement with creditors on rescheduling Peru's external debt. An official multilateral debt rescheduling agreement was subsequently signed on June 5, 1984, but for purposes of Fund jurisdiction under Article VIII, approval was granted only until the signing of respective bilateral agreements. Since these were never signed, approval has since lapsed.

3/ The review of the stand-by arrangement scheduled before June 1985 was not completed and Somalia became overdue in its obligations to the Fund.

In the case of Zambia, the second review of the stand-by arrangement was not completed owing to an increase in payments arrears and the arrangement was subsequently cancelled on February 7, 1986. As was noted in the previous reports, since January 1983 the Executive Board has not approved external payments arrears in the context of stand-by or extended arrangements when purchases under the arrangement could not be made because of nonobservance of a performance criterion, including that related to payments arrears.

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Table 1. External Payments Arrears Outstanding, 1976-1986 1/
(In millions of SDRs; end of period)

	1976	1977	1978	1979	1980	1981	1982	1983	1984	1985 2/	1986 2/	1985 Arrears as percentage of 1984 Imports
Afghanistan					x	x	x	x	x	x	x	...
Antigua and Barbuda	—	—	—	1	2	3	8	14	19	21	...	14
Argentina*	—	—	—	—	—	—	6,590	13,105	19,674	1,493	...	32
Belize*	—	—	—	—	—	—	—	5	6	—	—	—
Benin	...	—	—	22	—	—	11	49	89	156	169	64
Bolivia	—	—	—	12	126	104	228	438	727	922	980	200
Brazil	—	—	—	—	—	—	—	2,235	—	2,094	2,650	17
Burkina Faso	—	—	—	—	—	13	25	27	37	64	...	33
Central African Republic*	35	39	8	42	63	43	45	28	12	4	—	3
Chad	9	9	5	4	9	37	42	48	51	55	60	46
Comoros	—	—	—	—	—	1	1	2	3	4	...	13
Congo	4	4	23	31	14	34	30	62	97	212	175	33
Costa Rica*	—	—	—	—	234	565	1,007	38	219	30	109	3
Côte d'Ivoire*	—	—	—	—	—	—	—	174	53	—	—	—
Dominican Republic*	11	—	—	17	37	54	165	137	501	151	...	10
Ecuador*	—	—	—	—	—	—	—	191	97	60	—	—
Egypt	312	862	—	—	—	—	—	—	...	3,173	...	29
El Salvador	—	—	—	—	45	80	80	53	99	87	29	10
Equatorial Guinea*	—	—	—	—	—	2	9	20	43	29	1	81
Gabon	—	430	339	—	—	—	—	—	—	—	...	—
The Gambia	—	—	—	—	9	20	12	43	52	54	79	57
Ghana*	192	201	393	324	269	440	524	420	237	159	178	26
Grenada	x	x	2	1	—	—	—	1	1	1	...	2
Guatemala	—	—	—	—	—	—	261	273	500	533	498	46
Guinea	90	119	151	90	87	123	177	225	287	346	191	87
Guinea-Bissau	7	7	8	5	2	5	9	14	18	24	32	40
Guyana	—	27	17	22	34	101	220	391	546	643	774	300
Haiti	—	—	—	—	—	18	19	9	3	11	...	3
Honduras	—	—	—	—	—	12	52	99	172	188	172	22
Jamaica*	—	22	48	42	89	39	—	86	112	101	59	9
Liberia*	—	—	—	—	—	10	2	14	22	86	179	21
Madagascar*	5	7	11	13	175	103	213	96	81	73	...	20
Mali*	—	11	18	27	38	54	31	9	—	4	—	2
Mauritania*	x	9	23	15	28	20	37	59	107	—	—	—
Mexico	—	—	—	—	—	—	1,240	267	—	—	...	—
Morocco*	—	—	—	—	—	—	253	—	127	224	456	6
Mozambique	—	—	—	—	—	—	—	285	751	838	1,325	155
Nicaragua	—	—	58	363	621	453	393	489	641	633	...	87
Nigeria	—	—	—	—	—	—	1,948	4,360	4,903	3,861	...	48
Paraguay	—	—	—	—	—	—	—	86	94	145	...	13
Peru	...	...	115	—	—	—	—	21	1,420	2,585	4,639	115
Philippines*	—	—	—	—	—	—	—	1,565	2,744	—	—	—
Poland	...	...	...	...	...	...	...	...	...	640	764	—
Romania	—	—	—	—	—	981	352	—	—	—	85	—
St. Lucia	—	—	—	—	—	—	—	x	1	1	...	1
Sao Tomé & Príncipe	—	—	—	—	—	9	8	9	6	11	9	39
Senegal*	—	—	—	—	7	12	—	—	—	26	—	3
Sierra Leone	4	15	25	39	55	113	200	240	236	272	315	192
Somalia	—	—	—	13	35	40	50	79	120	42	65	10
South Africa	—	—	—	—	—	—	—	—	—	6,094	7,850	28
Sudan	241	572	597	878	848	1,293	1,428	1,121	963	1,599	...	120
Suriname	—	—	—	—	—	—	—	—	44	61	—	17
Tanzania	4	2	55	126	254	294	364	516	709	892	...	103
Togo*	—	8	34	21	22	64	162	1	4	—	—	—
Turkey	202	1,710	1,523	1,769	1,266	275	—	—	—	—	—	—
Uganda	29	21	63	68	172	130	113	75	60	72	...	15
Venezuela	—	—	—	—	—	—	748	3,916	4,489	4,827	4,864	38
Viet Nam	—	—	—	—	—	33	224	380	582	508	670	28
Western Samoa	—	—	—	—	1	9	13	3	2	1	1	2
Yugoslavia*	—	—	—	—	—	—	295	—	—	1,477	...	15
Zaire*	385	671	950	1,118	450	530	848	372	181	101	59	15
Zambia*	223	394	496	351	461	500	725	597	568	572	513	81
Total	1,753	5,140	4,962	5,414	5,453	6,617	19,353	32,653	42,473	36,200	...	...

Memorandum Item:

Aggregate amount resched-
uled in each year 3/ 334 457 2,222 4,462 3,769 1,893 5,525 67,585 37,491 118,517 ...

Sources: National authorities and Fund staff estimates.

1/ The table shows data on countries known to have had external payments arrears in any year during the period 1976-1986 or other dates indicated in the footnotes. Defaults, i.e., payments arrears incurred by governments participating in common central bank arrangements (Bank of Central African States (BEAC), Central Bank of West African States (BOEAO), and Eastern Caribbean Central Bank (ECCB)) resulting from the government's inability to obtain domestic currency with which to purchase needed foreign exchange from the common central bank, as well as those incurred by the government or a government entity whose financial operations form part of the budgetary process, are included in these figures. In the former case, since it is not possible to distinguish between domestic and external arrears, total arrears are shown.

2/ Most recent estimates available; where end-year data are not available, data at the end of the most recent period are used to arrive at totals.

3/ Amounts are with respect to Fund member creditors and include rescheduling of arrears and service obligations not yet due.

Symbols: * Financial program supported by use of Fund resources in effect in December 1985 (including arrangements under which purchases have been suspended). x Arrears less than SDR 0.5 million.

Table 2. External Payments Arrears, Reschedulings, and Cash Payments, 1984-85.

(In millions of U.S. dollars)*

	Outstanding stock of arrears end-1983	Reschedulings in 1984		Cash payments against arrears	Arrears incurred in 1984	Outstanding stock of arrears end-1984	Reschedulings in 1985		Cash payments against arrears	Arrears incurred in 1985	Outstanding stock of arrears end-1985
		Total	Arrears				Total	Arrears			
Afghanistan	x	—	—	—	—	x	—	—	—	—	x
Antigua and Barbuda	14.6	—	—	—	4.8	19.4	—	—	—	0.6	20
Argentina	13,720	—	—	—	6,015	19,285	16,938	13,316	4,329	—	1,640
Belize	5.1	—	—	—	1.2	6.3	2.9	2.9	3.4	—	—
Benin	51.5	—	—	—	35.7	87.2	—	—	—	84.7	171.9
Bolivia	459	459	—	—	315	713	—	—	—	300	1,013
Brazil	2,340	20,646	2,340	—	—	—	—	—	—	2,299	2,299
Burkina Faso	28.5	—	—	—	7.7 1/	36.2	—	—	—	33.8 1/	70
Central African Republic	27.6	—	13	2.1	1.2	15	13	7	5	—	3
Chad	50	—	—	—	2	52	—	—	—	8	60
Comoros	2.1	—	—	—	1.1	3.2	—	—	—	1.1	4
Congo	65	—	—	65	102	102	—	—	102	200	200
Costa Rica	40.3	153.7	—	31.6	205.8	214.5	606	86.2	114.6	19.3	33
Côte d'Ivoire	182.1	504	—	130	—	52.1	481	—	52.1	—	—
Dominican Republic	143	—	—	—	357	201	1,077	201	150	—	149
Ecuador	101	—	—	40	—	61	4,710	61	—	—	—
Egypt 2/	1,250	—	—	—	520	1,770	—	—	—	1,715	3,485
El Salvador	57	—	—	—	42	99	—	4	—	—	95
Equatorial Guinea	21.2	1	—	—	13.8	35	38	30.6	1.2	—	3.2
The Gambia	43	—	—	—	11	54	—	—	—	8	62
Ghana	440	—	137 3/	70	—	232	—	—	60	3	175
Grenada	1	—	—	1.5	1.5	1	—	—	0.5	0.5	1
Guatemala	286	—	—	—	204	490	—	—	—	95	585
Guinea	235	—	—	—	46	281	—	—	—	52	333
Guinea-Bissau	15	—	—	—	2.5	17.5	—	—	—	7.5	25
Guyana	409.0	35.0	—	—	126.5	535.5	47.0	—	—	171.0	706.5
Haiti	10	—	—	7	—	3	—	—	—	7	10
Honduras	104	—	—	—	64.2	108.2	—	—	—	37.9	206.1
Jamaica	90	5,240	...	...	...	112	257	...	...	...	110
Liberia	33	35 4/	—	—	...	23	18	—	28	...	142
Madagascar	100	284	70	—	67	88	128	—	8	—	80
Mali	10 5/	—	—	10	—	—	—	—	—	3	3
Mauritania	61.9	30.1	—	—	42.8	104.7	145.9	79.1	25.6	—	—
Mexico	280.1	3,800	—	280.1	—	—	48,700	—	—	—	—
Morocco	—	1,307	—	—	129	129	2,535 6/	—	129	227	227
Mozambique	285	404	...	...	...	550	—	—	...	...	719
Nicaragua	512	370	92	—	208	628	404	205	—	272.4	695.4
Nigeria	5,980	—	257	—	281	6,004	—	1,403	—	1,594	6,554
Paraguay	192.3	—	—	—	35.2	227.5	—	—	—	57.5	285
Peru	22	704	—	—	1,370 1/	1,392	—	—	—	1,447	2,839
Philippines	1,495	750	—	—	1,195	2,690	5,503	2,140 7/	550	—	—
St. Lucia	0.5	—	—	0.5	1	1	—	—	1	—	—
Sao Tomé and Príncipe	12	—	—	6	—	6	—	—	6	12	12
Senegal	—	77	—	—	—	—	73	—	—	28.8	28.8
Sierra Leone	251	50	25	—	5	231	—	—	—	53	284
Somalia	83	62	—	—	106	189	151	109	25	52	107
South Africa	—	—	—	—	—	—	—	—	—	6,694	6,694
Sudan	1,174	1,107	—	231	—	943	—	—	—	813	1,756
Suriname	—	—	—	—	—	43	—	—	—	24	67
Tanzania	540	—	—	—	—	695	—	—	—	284	979
Togo	1	75	—	—	155	3	—	—	3	—	—
Uganda	78	—	—	19	—	59	—	—	—	20	79
Venezuela	3,497	—	—	1,315	1,421	3,603	21,203	1,810	719	1,352	2,426
Viet Nam	433.7	—	—	—	236.4	670.1	—	—	—	54.4	724.5
Western Samoa	2.7	0.9	0.9	0.88	0.8	1.7	0.08	0.08	0.88	.32	1.08
Yugoslavia	—	1,750	—	—	—	—	4,418	—	—	1,622	1,622
Zaire	372	64	137 8/	12	57	280 9/	469	—	40	...	156
Zambia	625	327	...	...	...	556	—	—	...	...	540
Totals	36,232	38,236	3,072	2,231	13,390	43,703	107,918	19,455	6,353	19,654	38,490

Sources: National authorities and Fund staff estimates.

1/ Net accumulation.

2/ Stock outstanding as of end-June of the corresponding year.

3/ This figure represents the consolidation of arrears on oil import credits owed to Nigeria.

4/ Refers to fiscal year beginning July 1.

5/ Excluding external arrears of Air Mali.

6/ Including a rollover of US\$750 million short-term debt.

7/ Including US\$698 million of unremittable/undocumented arrears and a US\$638 million rollover trade facility.

8/ Rescheduling from Paris Club in December 1983.

9/ Includes US\$85 million of Treasury arrears.

* Totals do not sum exactly, i.e.,

arrears (t + 1) = arrears (t - 1)

- cash payments (t)

- rescheduling of arrears (t)

+ new arrears (t),

owing to missing information for some countries.

Table 3. Payments Delayed and Deferred by Non-Oil Developing Countries
in Relation to Imports and Debt, 1978-85. 1/

(In millions of U.S. dollars)

	1978	1979	1980	1981	1982	1983	1984	1985
a. Arrears	6,464	7,132	6,955	7,702	21,348	34,186	41,632	39,762
b. Rescheduling <u>2/</u> (including rescheduling of arrears)	2,895	5,878	4,807	2,203	6,095	70,758	36,749	130,181
c. Cumulative rescheduling of amounts fallen due net of payments <u>3/</u>	7,229	12,637	16,870	19,016	26,620	74,129	80,951	195,972
d. Imports of non-oil developing countries	263,312	332,457	435,683	460,356	422,232	392,597	405,516	400,259
e. Total outstanding debt of non-oil developing countries	360,513	430,653	518,522	609,491	703,102	749,415	788,494	834,960

Sources: IMF, IFS, and staff estimates.

1/ Including Nigeria and Venezuela.

2/ Amounts rescheduled in each year (past and future obligations) are with respect to Fund member creditors.

3/ Outstanding amounts already due that have been rescheduled, net of estimated payments in respect of rescheduled amounts.

Table 4. External Payments Arrears by Type of Payments, 1983-85 1/

(In millions of U.S. dollars)

	1983				1984				1985			
	Import payments	Invisible payments ^{2/}	External debt service payments		Import payments	Invisible payments ^{2/}	External debt service payments		Import payments	Invisible payments ^{2/}	External debt service payments	
			Interest	Princip.			Interest	Princip.			Interest	Princip.
Argentina	1,782	476 ^{3/}	856	108	1,524	716 ^{3/}	1,780	143	168 ^{4/}	832 ^{3/4/}	2,191 ^{4/}	147 ^{4/}
Benin	—	—	9.6	21.8	—	—	13.1	24.2	—	—	—	—
Bolivia	—	—	79.0	359.0	—	—	1,162	551	—	—	203	719
Burkina Faso	—	—	2.8	1.4	—	—	5.7	3.2	—	—	9.7	16.5
Central African Republic	—	—	3.8	18.0	—	—	0.8	5.8	—	—	—	—
Costa Rica	—	—	17.9	22.4	26.0	—	104.1	84.4	—	—	6.5	26.1
El Salvador	37.4	—	—	—	55.7	—	—	—	63.9 ^{4/}	—	—	—
Ghana	331.4	26.8	—	—	141.5	23.3	—	—	137.9	13.7 ^{4/}	—	—
Guatemala	14.2 ^{5/}	—	—	—	22.4 ^{5/}	—	—	—	22.8 ^{5/}	—	—	—
Guinea	—	—	46.1	155.0	—	—	54.0	169.6	—	—	70.3	225.2
Guinea-Bissau	—	—	1.9	2.9	—	—	2.6	5.4	—	—	—	—
Guyana	131.4 ^{6/}	—	47.8	229.8	128.7 ^{6/}	—	74.0	332.8	114.8 ^{6/}	—	128.3	433.4
Honduras	—	—	8.9	95.1	27.8	—	10.8	129.6	27.7	—	15.1	163.3
Mali	—	—	0.9	0.1	—	—	1.3	0.2	—	—	...	...
Mauritania	—	—	8.1	11.6	—	—	17.6	23.2	—	—	...	...
Mozambique	—	—	63	222	—	—	111 ^{7/}	434 ^{7/}	—	—	..	...
Nigeria	—	—	82 ^{8/}	—	—	—	232 ^{8/}	749 ^{8/}	—	—	82 ^{8/}	749 ^{8/}
Philippines	—	—	236.0	1,298.0	—	—	339	1,600	—	—	334	1,361
Sierra Leone	145.3	—	15.0 ^{9/}	60.4 ^{9/}	137.6	—	12.9 ^{9/}	50.3 ^{9/}	152.0	—	26.6 ^{9/}	62.0 ^{9/}
Somalia	—	—	—	—	45	—	—	47 ^{10/}	...	—	...	...
Sudan	—	—	—	—	—	—	—	—	—	—	24 ^{11/}	—
Tanzania	—	—	100	193	249 ^{12/}	—	133	313	—	—	—	—
Uganda	—	—	—	—	—	—	—	—	—	—	—	79.0 ^{8/}
Viet Nam	—	—	62.3	336.3	—	—	95.5	486.8	—	—	116.7	471.7
Western Samoa	—	—	—	2.7 ^{13/}	—	—	—	1.7 ^{13/}	—	—	1.1	— ^{13/}
Zaire	—	206.2 ^{14/}	—	183.2 ^{15/}	—	123.5 ^{14/}	—	54.0 ^{15/}	—	71.4 ^{14/}	—	39.5 ^{15/}
Zambia	246.9	225.7	—	—	212.7	206.1	—	—	237.9 ^{16/}	228.8 ^{16/}	—	—

Sources: Country authorities; and staff estimates.

1/ Table does not show data on all countries in Table 1 because data in some countries are unreliable or do not exist.

2/ Excludes interest payments on external debt.

3/ Primarily arrears on services and transfers.

4/ June 30, 1985.

5/ Government import arrears.

6/ Commercial and other current payments arrears excluding arrears on account of merchandise and other current payments without local currency counterparts.

7/ After Paris Club debt relief.

8/ Rescheduled arrears.

9/ Official debt service arrears.

10/ Includes interest.

11/ October 1985 - September 1986.

12/ Commercial arrears.

13/ Includes arrears on payments of principal and interest on government and government-guaranteed debt.

14/ Commercial and invisible arrears.

15/ Total public debt arrears including interest.

16/ February 1985.

Table 5. Treatment of Payments Arrears Under Stand-By or EFF Arrangements in Effect as of June 30, 1986 ^{1/}

Country	Type of arrangement, effective date amount, percent of quota	Total amount of payments arrears outstanding at time of program formulation (SDR million)	Reduction/ elimination of payments arrears as performance criterion 2/		Targeted amount of payments arrears reduction/ elimination	
			During program period	First year of program period	During program period	First year of program period
Argentina ^{3/}	15 months, S.B., 12/28/84; SDR 1,419 m 127.5 percent	4,470	--	Yes (E)	--	4,470
Bolivia	1 yr. S.B., 6/19/86 SDR 50 m 51.1 percent	990	Yes (E)	--	990	--
Central African Republic	18 months S.B., 9/23/85; SDR 15 m 49.3 percent	12	--	Yes (E)	--	12
Côte d'Ivoire	24 months S.B., 6/23/86 SDR 100 m 60 percent	200 ^{4/}	--	Yes (E)	--	200
Equatorial Guinea	1 yr. S.B., 6/28/85; SDR 9.2 m 50 percent	35	Yes (E)	--	35	--
Guinea	13 months S.B., 3/3/86; SDR 33 m 57 percent	260	--	Yes (R)	--	3
Mali	17 months S.B., 11/8/85; SDR 22.86 m 45 percent	6.3	--	Yes (E)	--	6.3
Morocco	18 months, S.B., 9/12/85; SDR 200 m 65.2 percent	40	--	-- ^{5/}	--	40
Philippines ^{6/}	18 months, S.B., 14/12/84; SDR 615 m 93.1 percent	2,744	--	Yes (E)	--	2,744
Senegal	18 months, S.B., 1/16/85; SDR 76.6 m 90 percent	^{7/}	--	Yes (E)	20	--
Somalia	1 yr. S.B., 2/22/85; SDR 22.1 m 50 percent	180	Yes (E)	--	180	--
Zaire	22 months S.B., 5/28/86 SDR 214.2 m 73.6 percent	64.8	--	Yes (R)	--	18
Zambia	24 months, S.B., 2/21/86; SDR 229.8 m 85 percent	505	--	Yes (E)	--	--

Table 5. (Concluded) Treatment of Payments Arrears Under Stand-By or EFF Arrangements in Effect as of June 30, 1986 ^{1/}.

Country	Ratio of targeted payments arrears reduction/elimination to total arrears		Ratio of targeted payments arrears reduction/elimination to drawing		Rescheduling of arrears as prior action or objective ^{10/}	Net cash reduction of arrears as separate performance criterion	Drawing interrupted due to non-observance of performance criteria on arrears ^{11/}	Counterpart deposit requirement ^{12/}	Approval status ^{13/}
	During program period (In percent)	First year of program period	During program period ^{8/}	First year of program period ^{9/}					
Argentina	--	100	--	472	Yes (O)	No	Yes (W)	Yes	Yes (T)
Bolivia	100	--	1980	--	Yes (O)	Yes	Yes (W)	No	Yes (T)
Central African Republic	--	100	--	218	Yes (O)	Yes	Yes (W)	No	No ^{14/}
Côte d'Ivoire	100	--	--	--	Yes (O)	No	No	No	No ^{14/}
Equatorial Guinea	100	--	380	--	Yes (O)	Yes	No	No	No ^{14/}
Guinea	--	1.0	--	9	Yes (O)	Yes	Yes (M)	No	Yes (T)
Mali	--	100	--	48	Yes (O)	Yes	No	No	No ^{14/}
Morocco	--	100	--	67	Yes (O)	No	No	No	Yes (T)
Philippines	--	100	--	633	Yes (O)	No	Yes (W)	Yes	Yes (T)
Senegal	100	--	26	--	Yes (O)	No	Yes (W)	No	No ^{14/}
Somalia	100	--	814	--	Yes (P)	Yes	Yes (W)	No	Yes (T)
Zaire	--	28	--	19	Yes (P)	Yes	No	Yes	Yes (T)
Zambia	--	7	--	75	Yes (O)	No	Yes ^{15/}	Yes	No

Source: Executive Board papers dealing with use of Fund resources.

^{1/} Includes arrangements under which purchases have been suspended. There were no extended arrangements as of June 30, 1986 for any member maintaining external payments arrears.

^{2/} Yes (E), elimination; Yes (R), reduction.

^{3/} Extended to June 30, 1986 (see EBS/86/39, Supplement 1; 5/29/86).

^{4/} Estimate.

^{5/} The elimination of external payments arrears amounting to US\$40 million was to be carried by the end-July 1985 as a precondition of having the stand-by approved and thus there were no provisions as such for eliminating external arrears under the program.

^{6/} The arrangement was canceled on June 9, 1986.

^{7/} Although Senegal had no outstanding external payments arrears at the time the program was formulated, arrears did develop subsequently and their elimination was made a performance criterion in the Third Review of the Stand-By Arrangement (See EBS/86/44; 2/27/86).

^{8/} Ratio of payments arrears reduction specified for the program period to total amount of arrangement.

^{9/} Ratio of payments arrears reduction during the first year of program period to drawings during the first year of program period unless otherwise specified.

^{10/} Yes (P), prior action; Yes (O), objective only.

^{11/} Yes (W), waiver; Yes (M), modification.

^{12/} One hundred percent unless otherwise stated.

^{13/} Yes (T), temporary approval.

^{14/} Payments arrears considered as defaults not exchange restrictions.

^{15/} Neither a waiver nor a modification has been granted.

Table 6. Settlements of Payments Arrears
by Cash Payments and Rescheduling, 1984-1985 1/

	1984 <u>2/</u>		1985 <u>2/</u>	
	Proportion settled through cash payments	Proportion settled through rescheduling	Proportion settled through cash payments	Proportion settled through rescheduling
Argentina	--	--	24.5	75.5
Belize	--	--	54.0	46.0
Bolivia	--	100.0 <u>3/</u>	--	--
Brazil	--	100.0	--	--
Central African Rep.	13.9 <u>3/</u>	86.1 <u>3/</u>	41.7	58.3
Costa Rica	--	--	40.3 <u>3/</u>	59.7 <u>3/</u>
Côte d'Ivoire	100.0	--	100.0	--
Dominican Rep.	--	--	42.7	57.3
Ecuador	--	--	--	100.0
El Salvador	--	--	--	100.0
Equatorial Guinea	--	--	3.8	96.2
Ghana	34.1	65.9	100.0	--
Haiti	100.0	--	--	--
Madagascar	11.4	88.6	100.0	--
Mali	100.0	--	--	--
Mauritania	--	--	23.4	76.6
Mexico	100.0	--	--	--
Morocco	--	--	100.0 <u>3/</u>	--
Philippines	--	--	20.4	79.6
St. Lucia	--	--	100.0	--
Sao Tomé and Príncipe	50.0	--	--	--
Sierra Leone	--	100.0	--	--
Somalia	--	--	18.7 <u>3/</u>	81.3 <u>3/</u>
Togo	--	--	100.0	--
Uganda	100.0	--	--	--
Venezuela	100.0	--	28.4 <u>3/</u>	71.6 <u>3/</u>
Western Samoa	50.0 <u>3/</u>	50.0 <u>3/</u>	91.7	8.3
Zaire	8.1	91.9	100.0	--

Source: Table 2.

1/ Refers only to cases where a net reduction or elimination took place.

2/ As percent of amount of reduction or elimination.

3/ Although a net reduction took place, new arrears incurred during the year. Figures therefore represent ratios between cash payments and rescheduling.

Table 7. Treatment of Payments Arrears in Executive Board Decisions, January 1, 1984 - December 31, 1985 1/

	Year of Executive Board Consideration of Exchange System	Recognition of Payments Arrears as Exchange Restriction	Fund Approval at time of Executive Board Consideration <u>2/</u>
Antigua and Barbuda <u>3/</u>	1985	No	--
Argentina <u>3/</u>	1985	Yes	Yes
	1984	Yes	Yes
Belize <u>3/</u>	1985	No	--
	1984	No	--
Benin	1985	No	--
Bolivia <u>3/</u>	1985	Yes	No
	1984	Yes	Yes
Brazil	1985	Yes	No
	1984	Yes	Yes
Burkina Faso	1985	No	--
	1984	No	--
Central African Republic	1985	No	--
	1984	No	--
Chad	1985	No	--
	1984	No	--
Congo	1985	No	--
	1984	No	--
Costa Rica <u>3/</u>	1985	Yes	No
Côte d'Ivoire	1985	No	--
	1984	No	--
Dominican Republic <u>3/</u>	1985	Yes	Yes
Ecuador <u>3/</u>	1985	Yes	Yes
	1984	Yes	Yes
Egypt	1985	Yes	No
El Salvador <u>3/</u>	1985	Yes	No
	1984	Yes	No
Equatorial Guinea	1984	Yes	Yes
The Gambia	1985	Yes	No
	1984 (November)	Yes	No
	1984 (April)	Yes	Yes
Ghana	1985	Yes	Yes
	1984	Yes	Yes
Grenada	1985	No	--
	1984	No	--
Guatemala <u>3/</u>	1985	Yes	No
	1984	Yes	No
Guinea	1985	Yes	No
	1984	Yes	No
Guinea-Bissau	1985	Yes	No
	1984	Yes	Yes
Guyana <u>3/</u>	1985	Yes	No
	1984	Yes	No
Haiti <u>3/</u>	1985	Yes	No
Honduras <u>3/</u>	1985	Yes	No
	1984	Yes	No
Jamaica <u>3/</u>	1985	Yes	Yes
	1984 (December)	Yes	Yes
	1984 (June)	Yes	Yes
Liberia	1985	Yes	No
	1984	No	--
Madagascar	1985	Yes	Yes
	1984	Yes	Yes
Mali	1985	No	--
Mauritania	1984	Yes	No
	1985	Yes	No
Mexico <u>3/</u>	1984	Yes	Yes
Morocco	1985	Yes	Yes
Mozambique	1985	Yes	No
Nicaragua <u>3/</u>	1985	Yes	No
	1984	Yes	No
Nigeria	1984	Yes	No
Paraguay	1985	Yes	No
	1984	Yes	No
Peru <u>3/</u>	1984	Yes	Yes
Philippines	1985	Yes	Yes
	1984 (December)	Yes	Yes
	1984 (June)	Yes	No
Sao Tomé and Príncipe	1984	No	--
Senegal	1985	No	--
Sierra Leone	1985	Yes	No
	1984 (December)	Yes	No
	1984 (February)	Yes	Yes
Somalia	1985	Yes	No
Sudan	1985	Yes	No
	1984 (April)	Yes	Yes

Table 7 (Concluded). Treatment of Payments Arrears in Executive Board Decisions, January 1, 1984 - December 31, 1985 1/

	Years of Executive Board Consideration of Exchange System	Recognition of Payments Arrears as Exchange Restriction	Fund Approval at time of Executive Board Consideration <u>2/</u>
Tanzania	1984	Yes	No
	1985	Yes	No
Togo	1984	No	--
	1985	No	--
Uganda	1984	Yes	Yes
	1985	Yes	No
Venezuela <u>3/</u>	1984	Yes	No
	1985	Yes	No
Viet Nam	1984	Yes	No
	1985	Yes	No
Western Samoa	1984	Yes	Yes
	1985	No	--
Yugoslavia	1984	Yes	Yes
	1985	Yes	Yes
Zaire	1984	Yes	Yes
	1985	Yes	Yes
Zambia	1984	Yes	Yes
	1985	Yes	No

Sources: Staff reports for Article IV consultations or Executive Board papers dealing with use of Fund resources.

1/ Refers to the most recent year of Article IV consultation decisions or approval of use of Fund resources when the country was known to have incurred payments arrears during January 1984 - December 1985. In instances in which Executive Board decisions have not been adopted since 1984, the record of the most recent decision is shown.

2/ Approvals were granted on a temporary basis.

3/ Member has accepted obligations under Article VIII of the Fund's Articles of Agreement.

FOR
AGENDA

EBS/86/271

CONFIDENTIAL

December 2, 1986

To: Members of the Executive Board
From: The Secretary
Subject: Sale and Use of Currencies of Members in Arrears to the Fund

The attached paper on the sale and use of currencies of members in arrears to the Fund is proposed to be brought to the agenda for discussion on Wednesday, January 7, 1987.

Mr. Blalock (ext. 8341) or Mr. Corr (ext. 7621) is available to answer technical or factual questions relating to this paper prior to the Board discussion; Mr. Munzberg (ext. 6675) is available to answer legal questions.

Att: (1)

RETURN TO:

ETR FILES

INTERNATIONAL MONETARY FUND

Sale and Use of Currencies of Members in Arrears to the Fund

Prepared by the Treasurer's and Legal Departments

(In consultation with the Exchange and Trade Relations Department)

Approved by W.O. Habermeier and F.P. Gianviti

December 1, 1986

I. Introduction

In the course of the Executive Board's discussion in June of the six-monthly report on overdue financial obligations to the Fund and a paper on the legal aspects of ineligibility and subsequent actions by the Fund (EBM/86/92 and 86/93, 6/6/86), the question was raised whether it would be possible and desirable for the Fund to sell or use some of its holdings of the currencies of members in arrears to the Fund as a means of reducing the amount of those arrears. Among the possibilities mentioned by Executive Directors were sales to other members to cover some of their expenditures in the countries in question and use of these currencies in financing the Fund's administrative expenditures. It was agreed that the staff would prepare a paper on the matter. 1/

Accordingly, this paper examines the legal and practical scope for use by the Fund of its holdings of the currencies of members in arrears and discusses certain issues that arise in considering such use. 2/ Section II of the paper sets out the legal framework for sale or use by the Fund of its holdings of members' currencies. Section III discusses the possible techniques, purposes and effects of the use of the currencies of members in arrears, from the points of view of the Fund and of members. Section IV sets out some specific questions that would need to be considered if the Fund were to pursue use of the currencies in question. Section V provides a summary and some concluding remarks and questions for discussion.

1/ See the Chairman's summing up at the conclusion of the Board discussion in Buff Statement 86/102, (6/16/86).

2/ Although the discussion in June was in the context of possible steps by the Fund in the case of members that had been declared ineligible to use the Fund's general resources, sale or use of currencies need not be confined to those members.

II. Legal Framework under the Articles

The following paragraphs discuss the legal provisions relating to the sale or use by the Fund of currency holdings that should have been repurchased. Two types of transactions are examined involving either the sale of currencies against other currencies (paragraph 1) or the sale of currencies against SDRs (paragraph 2). The legal basis for the use of currencies by the Fund, particularly in administrative expenditures, is discussed in paragraph 3.

1. Transactions in currencies

a. General limitations on transactions by the Fund

(i) Article V, Section 2(a) 1/ limits the powers of the Fund with respect to the sale of its holdings of a member's currency. 2/ While the Second Amendment has provided the Fund with the authority to sell gold to members or others, 3/ no such general authority exists with respect to the sale of currencies. 4/ The authority to sell gold under the broad terms of Article V, Section 12(c) must be contrasted with the limited power of the Fund to sell currency under Article V, Section 2(a). The latter provision limits the sale of currencies to purchasers that are members, whereas there is no such limitation in the provision relating to the sale of gold. Article V, Section 2(a) states that "except as otherwise provided in this Agreement, transactions on the account of the Fund shall be limited to transactions for the purpose of supplying a member, on the initiative of such member, with special drawing rights or the currencies of other members...in exchange for the currency of the member desiring to make the purchase."

1/ Article V, Section 2(a) provides that: "Except as otherwise provided in this Agreement, transactions on the account of the Fund shall be limited to transactions for supplying a member, on the initiative of such member, with special drawing rights or the currencies of other members from the general resources of the Fund, which shall be held in the General Resources Account, in exchange for the currency of the member desiring to make the purchase."

2/ The limits on an exchange of currency holdings for SDRs are established by Article V, Section 6. (See paragraph 2 below.)

3/ Article V, Section 12(c) provides in part: "The Fund may sell gold for the currency of any member...." The commentary on the Second Amendment (II.I.8.b, page 47) states that "the Fund will be able to sell any part of the balance of the gold held on the date of the amendment to members or to others at a price based on prices in the market."

4/ The question whether the authority to sell currency was similar to the Fund's power to sell gold was raised at the Board discussion in June.

(ii) The limitation on the Fund's transactions 1/ under Article V, Section 2(a) is subject to the proviso "except as otherwise provided in this Agreement". The sale of a member's currency in the General Resources Account by the Fund otherwise than to a member is provided for in the Articles only in Schedule J. Schedule J prescribes that, upon withdrawal of a member and after certain conditions are fulfilled, "the Fund may in an orderly manner liquidate in any market the amount of currency which should have been redeemed" (paragraph 4; see also paragraph 8).

(iii) A sale of currency by the Fund to a member that is not the issuer of the currency can only take place "on the initiative of such member" (Article V, Section 2(a)). Consequently, the Fund cannot require members to enter into transactions to purchase another member's currency.

(iv) The member desiring to make a purchase has to meet the conditions of Article V, Section 3(b). In particular, the purchasing member has to represent that "it has a need to make the purchase because of its balance of payments or its reserve position or developments in its reserves" (Article V, Section 3(b) (ii)). 2/ The fact that the currency provided could be used by the member in its transactions would not be sufficient.

b. Rules on selection of currencies by the Fund

The Fund has the power to select the currencies available for purchases in accordance with the general provision of Article V, Section 3(d) and the special provision of Article V, Section 7(h).

(i) Rules

(a) Under Article V, Section 3(d), in order to place a currency in the operational budget, the Fund has to take into account, inter alia, the balance of payments and reserve position of the member 1/

1/ Under certain conditions, the Fund has the power to invest the holdings of a member's currency in marketable obligations (see Article V, Section 12(h) and (g), and Article XII, Section 6(f)).

2/ Prior to the Second Amendment the purchasing member had to represent that it presently needed the currency "for making in that currency payments which are consistent with the provisions of this Agreement" (Article V, Section 3(a)(i)).

3/ Article V, Section 3(d) provides that "the Fund shall adopt policies and procedures on the selection of currencies to be sold that take into account, in consultation with members, the balance of payments and reserve position of members, as well as the desirability of promoting over time balanced positions in the Fund." Article V, Section 3(d) also contains the proviso that "if a member represents that it is proposing to purchase the currency of another member because the purchasing member wishes to obtain an equivalent amount of its own currency offered by the other member, it shall be entitled to purchase the currency of the other member unless the Fund has given notice under Article VII, Section 3 that its holdings of the currency have become scarce."

The Fund has adopted policies and procedures for the selection of currencies to be sold. 1/

These policies and procedures include provisions on the sale by the Fund of the currency of a member with outstanding purchases. Decision No. 6274-(79/158), adopted September 14, 1979, 2/ states in its paragraph 2 that "under procedures to be adopted, the currency of a member with outstanding purchases subject to repurchase, whose balance of payments and gross reserve position is judged sufficiently strong for the purposes of operational budgets and designation plans, normally will be sold by the Fund under Article V, Section 3(d) only if the member and the Fund agree." 3/

However, Decision No. 6774-(81/35), adopted March 5, 1981, 4/ makes a distinction between (i) members with outstanding purchases subject to the guidelines on early repurchase (paragraph 2(a), and (ii) members with outstanding purchases not subject to the guidelines on early repurchase (paragraph 2(b)). 5/ In both cases, the Fund has to find that the balance of payments and gross reserve position of the member is sufficiently strong. Decision No. 6273-(79/158) G/S, adopted September 14, 1979, in its paragraph 4, provides criteria for this assessment. They include, inter alia, judgments on the improvement of the member's position in comparison with the position at the time of the last purchase from the Fund, and the extent and the sustainability for the foreseeable future of the improvement. The wording indicates the need for an assessment by the Fund that takes account of those additional factors, if the currencies under consideration were to be considered for inclusion in the operational budget.

1/ Decision No. 6273-(79/158) G/S, adopted September 14, 1979 (Selected Decisions, Twelfth Issue, page 104); Decision No. 6274-(79/158), adopted September 14, 1979 (Selected Decisions, Twelfth Issue, page 105); Decision No. 6772-(81/35) G/S, adopted March 5, 1981 (Selected Decisions, Twelfth Issue, page 110); Decision No. 8265-(86/70) S adopted April 25, 1986 (Selected Decisions, Twelfth Issue, page 112); and Decision No. 6774-(81/35), adopted March 5, 1981 (Selected Decisions, Twelfth Issue, page 112).

2/ Selected Decisions, Twelfth Issue, page 105.

3/ Emphasis Added.

4/ Selected Decisions, Twelfth Issue, page 112.

5/ The difference is relevant with respect to the procedures adopted by the Fund by Decision No. 6352-(79/183), adopted December 12, 1979 (Selected Decisions, Twelfth Issue, page 108), and modified with respect to the second alternative by the Annex to Decision No. 6774-(81/35), adopted March 5, 1981 (Selected Decisions, Twelfth Issue, page 112).

The difference between the two cases is that, with respect to members with outstanding purchases not subject to the guidelines on early repurchase, a sale of currency would take place only after an agreement between the member and the Fund, whereas in the case of members with outstanding purchases subject to the guidelines on early repurchase, the sale would normally be subject to an agreement between the Fund and the member. "Normally" implies that exceptions can be made. In this case the Fund could disregard a member's objection and proceed with the inclusion in the operational budget. Once the currency of a member has been included in the operational budget the member cannot object to its use in transactions by the Fund.

(b) With respect to holdings of a member's currency that the member has failed to repurchase, Article V, Section 7(h), which was introduced by the Second Amendment, authorizes the Fund to adopt policies supplementing the policies under Article V, Section 3(d). ^{1/} These policies have not been established. Their adoption would require a majority of the votes cast.

Under Article V, Section 7(h), the Fund can select, for inclusion in the currency budget, holdings of a member's currency that the member has failed to repurchase in accordance with Article V, Section 7 "even though, in the absence of that failure, the currency would not have been selected for a sale at that time." ^{2/} This provision, therefore, obviates the need for the Fund to find that the balance of payments and reserve position of a member is sufficiently strong.

The sale by the Fund does not require the member's agreement. It is only subject to a consultation with the member. An additional opportunity is thereby given to the member to fulfill its obligation to repurchase the Fund's holdings of its currency that should have been repurchased, but the member cannot prevent the Fund from selling its currency. The intention was expressed during the discussions of the Second Amendment that priority should be given to the sale of such currency holdings that should have been repurchased, and the similarity

^{1/} Article V, Section 7(h) provides that: "the Fund's policies under Section 3(d) of this Article may be supplemented by policies under which the Fund may decide after consultation with a member to sell under Section 3(b) of this Article its holdings of the member's currency that have not been repurchased in accordance with this Section 7, without prejudice to any action that the Fund may be authorized to take under any other provision of this Agreement."

^{2/} DAA 75-3 Sup. 1 (Documents Relating to the Second Amendment, Volume I, Part 1, page 873b).

of the designation of participants for corrective purposes under Article XIX, Section 5(a)(iii) was pointed out. 1/

(ii) Problems of implementation

(a) The necessary corollary of the Fund's power to select the currencies to be sold are the obligations imposed on the issuers of these currencies by the provision of Article V, Section 3(e). 2/ During the deliberations on the Second Amendment it was explained that Article V, Section 3(e) applies to a sale under Article V, Section 7(h), since it covers every sale of currency by the Fund. 3/ Article V, Section 3(e) 4/ imposes on the member whose currency is

1/ See remarks by the General Counsel at EBM/75/36 of March 24, 1975, Documents Relating to the Second Amendment, Volume II, Part 1, page 790-791: "The General Counsel said that Section 7(h) went beyond the general policy on the selection of currencies to be sold. The provision stated that notwithstanding that general policy, the currency in question would be given priority in sales. There was a parallel provision in the Special Drawing Account for the priority designation of a participant that had not observed the expectation of need. The participant, therefore, had to receive SDRs ahead of the participants that would be designated according to the economic criteria for designation."

2/ See Proposed Second Amendment, 1976, Commentary, II.D.11, page 23: "These provisions of Article V, Section 3(e) supplement Article V, Section 3(d) which empowers the Fund to select the currencies to be sold to members making purchases from the Fund."

3/ See the remarks by the General Counsel at EBM/75/36 of March 24, 1975 in Documents Relating to the Second Amendment, Volume II, Part 1, page 790: "...the member would have an obligation to convert if the Fund did use the procedure under Section 7(h). The effect of the sale would be to discharge the repurchase obligation."

4/ Article V, Section 3(e) reads:

"(i) Each member shall ensure that balances of its currency purchased from the Fund are balances of a freely usable currency or can be exchanged at the time of purchase for a freely usable currency of its choice at an exchange rate between the two currencies equivalent to the exchange rate between them on the basis of Article XIX, Section 7(a).

(ii) Each member whose currency is purchased from the Fund or is obtained in exchange for currency purchased from the Fund shall collaborate with the Fund and other members to enable such balances of its currency to be exchanged, at the time of purchase, for the freely usable currencies of other members.

(iii) An exchange under (i) above of a currency that is not freely usable shall be made by the member whose currency is purchased unless that member and the purchasing member agree on another procedure.

(iv) A member purchasing from the Fund the freely usable currency of another member and wishing to exchange it at the time of purchase for another freely usable currency shall make the exchange with the other member if requested by that member. The exchange shall be made for a freely usable currency selected by the other member at the rate of exchange referred to in (i) above."

purchased from the Fund the obligations to "ensure that balances of its currency purchased from the Fund are balances of a freely usable currency" or, (and this is most likely the relevant provision with respect to sales of currency under Article V, Section 7(h)), that such balances of its currency "can be exchanged at the time of purchase for a freely usable currency...." (Article V, Section 3(e)(i)). This exchange "shall be made by the member whose currency is purchased unless that member and the purchasing member agree on another procedure" (Article V, Section 3(e)(iii)).

(b) Once a currency is included in the operational budget, the purchasing member cannot object against receiving the currency sold. The criteria for selection of currencies are intended to provide a guarantee to the purchasing member that any currency will be either freely usable or be exchanged against a freely usable currency by the member whose currency is sold (the "issuing member"). Legally the member whose currency is included in the operational budget and sold under Article V, Section 7(h) has an obligation to exchange the currency if it is not freely usable and the purchasing member has a right to obtain such a freely usable currency (Article V, Section 3(e)). A member that does not comply with its obligation to provide a freely usable currency is in breach of an obligation under the Articles. ^{1/} The Fund must avoid imposing the negative consequences of a breach of an obligation by a member on another member. This principle is relevant for two possible cases with respect to a sale under Article V, Section 7(h):

(i) The Fund, after selling the currency to the purchasing member, finds that the issuing member does not fulfill its obligation to exchange the currency against a freely usable currency. If the purchasing member, at the time of the purchase, requested the exchange prescribed under Article V, Section 3(e)(i) and the exchange was not made, the purpose of the purchase would be frustrated as the purchasing member would not obtain a freely usable currency. The Fund would have the obligation to substitute another currency for the currency that is not exchanged by the issuing member. This situation has to be distinguished from a purchase where the purchasing member did accept the purchased currency and did not request the exchange at the time of the purchase. While in this case the purchasing member may subsequently

^{1/} The member failing to comply with its obligation to exchange its currency against a freely usable currency would violate an obligation under the Articles that may justify a declaration of ineligibility.

If the Fund finds that no exchange is made by the issuing member, it becomes apparent that the member's currency is not usable. Since it is one of the purposes of a quota increase to provide the Fund with additional usable resources, such a finding may have an effect on the participation in a quota increase of members whose currencies the Fund has found to be not usable.

attempt to sell the currency in the market and may find that such a sale is impossible or does not provide the member with a value equal to the value of its purchase from the Fund as recorded in the Fund's books, the Fund would have no obligation to substitute since no exchange was requested at the time of the purchase as required by Article V, Section 3(e)(i).

(ii) The Fund, before proceeding to the sale, finds that the issuing member will most likely not comply with its obligation of exchange. If, in this case, the Fund sold that currency, it would impose a currency on the purchasing member, while presuming that it will not be exchanged for a freely usable currency. The Fund would transfer its own risk to the purchasing member. A sale of currency under circumstances in which it is not reasonably certain that exchange will be made, if requested, should not be made or would therefore need to be accompanied by arrangements for substitution of another currency by the Fund in the event a requested exchange were not made.

The question of exchange would not arise where the purchase is made in order to make use of the currency provided by the Fund without need for an exchange. The Fund could consider adopting policies under Article V, Section 7(h) limited to circumstances in which the purchasing member could either use the currency or obtain an exchange.

(c) In the particular case of a member which is unable or unwilling to comply with its obligations under Article V, Section 3(e) the mechanism introduced by the Second Amendment through Article V, Section 7(h) and Article V, Section 3(e) will not operate. Under the present Articles the Fund has no power to dispose of these currency holdings on its own initiative in any other way and in particular not through a sale in the market. The Fund cannot use these currency holdings contrary to the purposes of Article V, Section 7(h) in circumstances where members do not observe their obligation to exchange. The member's compliance with its obligations under Article V, Section 3(e) is a necessary part of the mechanism.

It would be possible to examine in the context of an amendment of the Articles changes that would give effect to the purposes of Article V, Section 7(h), e.g., a sale by the Fund in the market in these specific circumstances. Such a modification of the Articles would require careful study.

(d) When an exchange of the purchased currency under Article V, Section 3(e)(i) for a freely usable currency takes place, the exchange rate between the two currencies must be equivalent to the exchange rate between them on the basis of Article XIX, Section 7(a) (Article V, Section 3(e)(i)). According to Rule 0-6(a)(i) the exchange of currency shall be made at an exchange rate between the two currencies corresponding to their exchange rates in terms of the SDR as determined under

Rule 0-2, if the exchange is requested under Article V, Section 3(e)(i). Under Rule 0-2 the value of a currency other than the United States dollar in terms of the SDR is to be determined on the basis of a representative rate; in the absence of such a representative rate, a rate has to be determined by the Fund.

Even if no exchange between members were necessary, the Fund would have to determine a rate at which it would account for the member's currency. This rate would be used to calculate the value of the purchase, to calculate the extent of the discharge of the obligations to the Fund of the member whose currency is sold, and to revalue the remaining Fund holdings of the member's currency. If the new rate were lower than the previously used rate, the member would have to make additional payments in its currency to the Fund under the maintenance of value provisions.

If an exchange is necessary and the exchange is not made by the issuing member, the Fund would have to revalue the holdings of the issuing member's currency on the basis of a rate determined by the Fund.

(e) The Fund has decided that a member is free to attribute the reduction in the Fund's holdings of its currency to any of its repurchase obligations and (subject to limitations) to enlarge its reserve tranche. ^{1/} An elimination (or reduction) of overdue obligations would only be ensured if the decision were amended by mandating the attribution of a reduction to overdue obligations. The Fund would be free to limit the scope of the amendment to a sale of currency under Article V, Section 7(h).

2. Transactions in currencies for SDRs

a. Transactions with participants

Under Article V, Section 6(a) "the Fund may accept special drawing rights offered by a participant in exchange for an equivalent amount of currencies of other members."

(i) The exchange of SDRs against currencies has to take place on the initiative of the participant wishing to sell SDRs. The Fund cannot initiate the transaction.

(ii) Contrary to the requirements with respect to a purchase by a member, the participant requesting an exchange under Article V, Section 6(a) does not have to represent a balance of payments need.

^{1/} Decision No. 6831-(81/65) as amended (Selected Decisions, Twelfth Issue, page 124). The decision contains limitations of the principle with respect to an attribution to an obligation to repurchase financed from borrowed resources and to an attribution to create a reserve tranche (paragraph 1(b) and (c) of the decision).

The transaction under Article V, Section 6(a) is not " a 'credit' transaction comparable to the transactions, other than reserve tranche purchases, in which a member makes purchases under Article V, Section 3 in return for its own currency." 1/

(iii) The major difference between transactions in SDRs and transactions in currencies is that the member whose currency is being sold by the Fund has to agree to the sale (Article V, Section 6(c)). 2/

(iv) Article V, Section 6(c) prescribes 3/ that the currencies provided by the Fund shall be selected in accordance with policies that take into account the principles of Article V, Section 3(d). While there is no specific reference to the policies adopted under Article V, Section 7(h), a sale of currency holdings that the member has failed to repurchase is not precluded. Article V, Section 6(c) does not refer to the policies to be adopted under Article V, Section 3(d), but to the principles guiding the adoption of these policies. These principles do not only comprehend the balance of payments and reserve position of members, but the desirability as well of promoting over time balanced positions in the Fund. The latter criterion is a relevant element with respect to currencies that should have been repurchased. It should also be noted that Article V, Section 6(c) only requires that these principles be taken into account in the selection of currencies to be sold. These considerations are, however, less important in the context of Article V, Section 6 than with respect to a purchase under Article V, Section 3. When a currency is included in the operational budget the issuing member cannot object to its use for a purchase. Under Article V, Section 6 the consent of the member whose currency is used is required. Accordingly, with the consent of the member whose currency is sold, it is possible for the Fund to exchange the currencies of members in arrears for SDRs.

b. Transactions with prescribed holders

Under Article XVII, Section 2 "the Fund may hold special drawing rights in the General Resources Account and may accept and use them in operations and transactions conducted through the General Resources Account with participants in accordance with the provisions of this Agreement or with prescribed holders in accordance with the terms and

1/ Proposed Second Amendment, 1976, Commentary, II.D.17, page 26.

2/ Article V, Section 6(c) (second sentence) reads: "The Fund may enter into transactions under the Section only if a member whose currency is provided or accepted by the Fund concurs in that use of its currency."

3/ Article V, Section 6(c) (first sentence) reads: "The currencies provided or accepted by the Fund under this Section shall be selected in accordance with policies that take into account the principles of Section 3(d) or 7(i) of this Article."

conditions prescribed under Section 3 of this Article." While the sale of currencies to a participant is provided for in Article V, Section 6, the Fund also has the power to enter into operations and transactions with prescribed holders. In order to give effect to this power, the Fund would have to prescribe, by a majority of votes cast, under Article XVII, Section 3(iii) "the terms and conditions on which...the Fund through the General Resources Account may enter into operations and transactions in special drawing rights with prescribed holders."

A sale of currencies by the Fund is a transaction in the sense of Article XVII, Section 2 (Article XXX(h)). Any prescription of terms and conditions of a transaction has to respect Article XVII, Section 3 (last sentence) which states that "terms and conditions prescribed by the Fund shall be consistent with the provisions of this Agreement and the effective functioning of the Special Drawing Rights Department". While the Articles do not establish specific criteria for the sale of currencies by the Fund to prescribed holders, the provisions of the Articles provide the general legal framework for such transactions, and conclusions can be drawn from provisions regulating similar cases.

Article V, Section 6 addresses the similar situation of a sale by the Fund to a participant. Insofar as the rationale expressed in the conditions of Article V, Section 6 applies to a sale to a prescribed holder, the conditions of Article V, Section 6 should, by analogy, be considered relevant for the similar case. The requirement of the consent of the issuing member is intended to give the member the right to protect its interest when the Fund sells its currency in a voluntary transaction. The rationale of this provision is relevant with respect to a transaction by an agreement between the Fund and a prescribed holder.

Article XIX, Section 7(a) states "that the exchange rates for transactions between participants...shall be such that participants using special drawing rights shall receive the same value whatever currencies might be provided and whichever participants provide these currencies...." Article XIX, Section 7(a) is referred to in Article V, Sections 10 and 11 on computations and maintenance of value with respect to currencies of members held in the General Resources Account. The principle expressed in these provisions is of a general nature and has to be applied to a transaction between the Fund and a prescribed holder.

Several provisions of the Articles establish the principle that the Fund cannot impose a transaction on a member or participant. Article V Section 2(a) states that transactions with a member shall take place on the initiative of such member. Article V, Section 6(a) and (b) provides that the Fund may accept SDRs, offered by a participant (a) and may provide a participant, at its request, with SDRs (b). Under Article XVII, Section 3(ii) prescribed holders "may accept" SDRs. It can be concluded that the general principle whereby the Fund may not

require a member or participant to enter into a particular transaction with the Fund, except as otherwise provided in the Agreement, would be relevant with respect to a transaction with a prescribed holder.

The Fund has not yet prescribed any terms and conditions for the sale by the Fund of currencies to other holders. The Board paper on "Other Holders of SDRs" (EBS/80/74, 4/1/80) discussed legal and policy considerations with respect to transactions between the Fund and other holders:

Other holders could be authorized to buy or sell SDRs in transactions with the Fund's General Resources Account but, as a matter of policy, it is not proposed that they be permitted to do so. While a broad authority is contained in the Articles of Agreement for transactions between the General Resources Account and participants, it has so far not been used except for limited and clearly defined purposes, such as the sale of SDRs to participants needing to acquire SDRs to pay charges or to reconstitute their SDR holdings under Article XIX, Section 6. These particular purposes would not be applicable to other holders. In the staff's view, if the Fund were generally to authorize transactions in SDRs between other holders and the General Resources Account the impression might be created that the Fund stood ready to act as a "buyer of last resort" supporting the market in SDRs. This would be a most undesirable situation since the market should be given the opportunity to develop and function on its own. This kind of support could also lead to the Fund receiving possibly very large amounts of SDRs, which could materially affect the management of the Fund's holdings of SDRs and currencies, as well as the volume and distribution of members' reserve positions in the Fund....

It cannot be wholly ruled out, however, that circumstances might arise in which a particular other holder would have a temporary need to buy or sell SDRs in a transaction with the General Resources Account.....there is nothing in the proposed decision that would preclude the Fund from deciding at any time to provide for dealings in SDRs between other holders and the General Resources Account.

It may be concluded, therefore, that it is legally possible for the Fund to prescribe sales, to a prescribed holder, in exchange for SDRs, of the currency of a member in arrears to the Fund. Such sales would require, in addition to the participation of the Fund, the concurrence of both the purchaser and the issuing member.

3. Use in the Fund's administrative expenditures and other uses

a. The Fund has the power to use its holdings of currencies for its administrative expenditures. Under Rule E-1, the Fund may maintain "administrative accounts", also called No. 2 Accounts, which can be

debited or credited with respect to the Fund's administrative expenditures and receipts payable in a member's currency. These expenses may be incurred by the member on behalf of the Fund or represent payments which the Fund may make or authorize for its own purposes.

The currency holdings in the Fund's accounts are in the sole ownership of the Fund. The Fund is, therefore, free to spend its holdings of a member's currency in the administrative account, provided, of course, that the expenditure is bona fide. Article IX, Section 6 prescribes that "to the extent necessary to carry out the activities provided for in this Agreement, all property and assets of the Fund shall be free from restrictions, regulations, controls, and moratoria of any nature." It is, therefore, the member's obligation to provide to the Fund unrestricted access to its assets.

If the Fund were to use the currencies of a member in arrears for administrative expenditures, the Fund would have to decide on the attribution of the reduction of its holdings of the member's currency to its obligations to the Fund.

b. The Fund may also use its holdings of a member's currency in several other circumstances. For example, currency holdings can be reduced as a result of a setoff, and under certain of the Fund's borrowing agreements the use of currencies for payments of interest or principal can be agreed between the Fund and the lender. In addition, under Article V, Section 9(d) "remuneration shall be paid in special drawing rights, provided that either the Fund or the member may decide that the payment to the member shall be made in its own currency."

III. Purposes and Effects of Use of the Currencies of Members in Arrears

Under the conditions outlined above, the Fund has the authority (i) to sell its holdings of a member's currency to other members in exchange for their currencies, (ii) to sell its currency holdings to other members or prescribed holders in exchange for SDRs, and (iii) to use its currency holdings, inter alia, for payments of administrative expenditures.

To facilitate consideration of the desirability and potential scope for the sale or use by the Fund of currencies of members in arrears, this section discusses possible purposes the use of these currencies might serve and describes the effects of any of these sales or uses on the financial position of the Fund, the members whose currencies would be sold or used, and other members.

1. Purposes and techniques of sales ^{1/}

a. In financing purchases

As noted, any sale of currency by the Fund, whether in financing a purchase or in exchange for SDRs, must be made at the initiative of the member (or prescribed holder) acquiring the currency. In financing a purchase under Article V, Section 3, the Fund has the ability to select the currency to be sold; but if the currency is not a freely usable currency, the issuing member has an obligation to exchange the currency purchased for a freely usable currency at equal value exchange rates, if so requested by the purchaser at the time of the purchase.

The question arises whether, in the context of sale of the currency of a member in arrears, it could be expected with confidence that the member would meet its exchange obligation or whether the purchasing member might have a desire to hold the purchased currency or use it directly in transactions. The member making the purchase must have a balance of payments need, and it would be expected in most cases that it would seek exchange of the currency purchased. ^{2/} If the issuing member failed to meet its exchange obligation, it would be in breach of a further obligation under the Articles, and the needs of the purchasing member--and the objective of the purchase--would be frustrated. Moreover, it may be considered that, if the issuing member were prepared to meet its exchange obligation, the more straightforward and preferable course would be for it to use the foreign exchange directly to settle its obligations to the Fund.

In the cases of most countries in arrears to the Fund, the members face serious balance of payments difficulties and are accumulating arrears not only to the Fund but also to other creditors. It would not appear prudent for the Fund to assume that these members would in fact meet their exchange obligations if their currencies were used to finance purchases in the circumstances discussed, and it would be contrary to the purposes of the Fund for the Fund to place the purchasing member at risk that an exchange would not be made. It might, therefore, be considered that, in the absence of a clear assurance that exchange would be made if requested by the purchaser, the Fund should not provide the currencies of members in arrears in financing purchases except at the specific request of the purchaser, and on the understanding that no exchange would be requested.

^{1/} The purposes discussed in this section could also be met through the use of the currencies of members in arrears for payments of interest and principal under certain of the Fund's borrowing agreements, in agreement with the lenders.

^{2/} It is the practice in the majority of cases that purchasers request exchange into U.S. dollars.

It is, nonetheless, for consideration whether in specific cases the Fund should not select the currencies of members in arrears in limited amounts to finance purchases as a test of members' resolve to clear the arrears. This step might be taken after other procedures have been exhausted following a declaration of ineligibility and could serve as a test of the willingness of the members concerned to meet their obligations under the Articles by making arrangements for the exchange of limited amounts of their currencies sold by the Fund. In the event that exchange were not arranged, the member in arrears would have failed to meet another obligation. However, as discussed above, the Fund should not place the purchasing member at risk, and it would be necessary to have fallback provisions for the Fund to make available a freely usable currency should the exchange not actually be made.

The possibility would remain open that a purchasing member might desire the currency purchased for its own purposes, for example, for use in payments for trade or to meet other expenses payable in the currency. It would be possible for the Fund to offer purchasing members the option of acquiring the currencies of members in arrears in all or part of any purchase, on the understanding that no official exchange would be needed or sought; and such offers could be made as part of the operational budgets and the Fund's operational communications with members requesting purchases. It is difficult to predict what use might be made of such a facility, but the staff would not expect that such offers would be taken up unless prior agreement had been reached between the issuer and the purchaser of the currency in question.

b. In exchange for SDRs

The Fund's ability to sell the currencies of members in arrears (with their concurrence) to other members or prescribed holders in exchange for SDRs may provide greater scope for use of these currencies. As the range of possible buyers would not be limited to those having a need for, and using, the Fund's general resources, there may be a larger potential demand for use of the currencies in question by other members, for example, in financing payments for trade, expenditures in local currency associated with aid programs, and diplomatic and administrative expenses in the country concerned. It is to be noted, however, that many members impose legal constraints on the media that can be accepted in payments by non-residents, and such constraints are imposed by a number of members that have experienced difficulties in making payments to the Fund.

It is also possible that other institutions, including some that are prescribed holders of SDRs, may have needs for the currencies of members in arrears, in particular associated with the provision of local cost financing as part of assistance programs, and that these needs could to some extent be satisfied indirectly through acquisition from the Fund. The Fund can sell a member's currency only to other

members that are participants, or prescribed holders. It would also be possible, assuming the agreement of all parties concerned, for a member, in effect, to intermediate between the Fund and another institution that is not a prescribed holder, by purchasing the currency from the Fund with SDRs and selling it immediately to the other institution in exchange for a freely usable currency (or any other agreed medium). Certain of the members presently in arrears to the Fund may receive significant local cost financing from international development institutions (most of which are prescribed holders). ^{1/} The latter's acquisition of currencies through transactions with the Fund could have a noticeable impact on the Fund's holdings in some cases although, as discussed below, this would effectively reduce the amount of balance of payments financing being provided to the member through this vehicle.

A further possibility is that some members of the Fund might be prepared to acquire and hold the currencies concerned as a means of assisting the members in arrears to become current with the Fund and as a cooperative step in assisting the Fund in dealing with the problem of overdue obligations. Although other techniques for providing financing of course exist and are more normally used for these purposes, it is possible that the technique of acquiring members' currencies from the Fund would provide a vehicle that would be considered useful in some instances.

The staff is not in a position to indicate with any assurance the potential demands for members' currencies for these purposes. To determine the possible amounts that might be involved in sales to finance trade, aid, diplomatic, and other local currency expenses would require detailed examination of the flows of such transactions for each member, for which data are presently unavailable in many cases, and consultation with both the members in arrears and other members having substantial trade and financial relations with these members. While it might be possible in this way to obtain broad indications of potential amounts, the actual sales that might be practical are likely also to be influenced importantly by the particular legal and institutional framework in which foreign exchange transactions are conducted in the individual country. With respect to agencies of member governments and other institutions having a need for the currencies of these members, these organizations may face substantial constraints of a legal or policy nature in acquiring local currencies. It would, therefore, be important to receive positive indications from individual Executive Directors and

^{1/} It may be noted, for example, that disbursements for local procurement of goods and services by the IBRD and IDA in FY 1986 in the five ineligible members were: Peru \$83.2 million; Liberia, \$8.8 million; Sudan, \$4.7 million; Guyana, \$0.4 million; Viet Nam, none. With the exception of Peru, however, these amounts are small in relation to the members' arrears to the Fund.

creditor members as to whether currency sales by the Fund would be viewed as a useful and practical way in which their authorities could provide financing to members in arrears as a means to assist in resolution of the problem of overdue obligations to the Fund. The staff would also welcome the guidance of Executive Directors as to whether the possibility of sales to other institutions should be actively explored with these institutions.

c. In financing the Fund's administrative expenses

The Fund has certain administrative expenses associated with activities in most of its member countries, such as mission travel, technical assistance, or resident representatives, and maintains administrative accounts in every member's currency. For the most part, these expenses are financed with U.S. dollars, though there are occasional local currency payments funded from the administrative accounts with the members in arrears. ^{1/} It would be possible to seek to increase the use of these currencies, for example, in payment of local airline, hotel, and subsistence costs and in financing local currency expenses related to technical assistance and the maintenance of resident representatives. In practice, however, there may be substantial obstacles to such use, as airlines normally require payment in dollars for trips originating in Washington and local hotels in many cases require non-residents to effect payment in foreign exchange.

A very rough calculation suggests that the amount potentially involved for mission-related local currency expenses in the five member countries that are presently ineligible to use the Fund's general resources would be on the order of about SDR 100,000 annually, or about 0.01 percent of these members' arrears outstanding at the end of September 1986. ^{2/} Technical assistance and the maintenance of resident representatives would in some cases provide further opportunities, but the local currency component of those expenses is also very small compared to the amounts of arrears.

A number of years ago, the Fund standardized the payment of such expenses in U.S. dollars as a means of simplifying administration. A change to require the use of local currencies in financing expenditures in certain member countries would give rise to considerable additional

^{1/} For example, administrative payments by the Fund in the currencies of the five members that have been declared ineligible to use the Fund's general resources have totaled the equivalent of about SDR 18,000 since the beginning of 1985.

^{2/} In connection with a forthcoming mission to one of the members concerned, it has been estimated that, as a practical matter, in light of hotel and airline requirements, local currency funding could be used for only about SDR 5-6,000 of the mission costs, largely for per diem.

administrative effort in accounting for advances in a variety of currencies, making special arrangements for the acquisition of local currency from depositories by mission members, technical advisors, or resident representatives, and tracking the re-deposit of any unused funds. In some countries, staff could be exposed to some additional risks of carrying relatively large amounts of cash.

In the staff's view, therefore, use of local currencies in financing administrative expenditures would not appear to be a particularly effective means of reducing members' arrears to the Fund.

2. Effects on the Fund and members

With respect to the effects on the Fund, it is assumed that the Fund would decide that any reductions in its currency holdings, resulting from a policy on use of the currencies of members in arrears, would be attributed to outstanding overdue repurchases. In that case, the sale or use of the currency of a member in arrears would, pro tanto, reduce that member's repurchase obligations to the Fund and the amount of arrears outstanding. Such use of the currencies of members in arrears would not, in itself, serve to settle overdue charges and thereby improve the Fund's income position. A reduction in arrears to the Fund through such use might lessen the effort required for the member to become fully current with the Fund, including in the payment of charges, and thereby contribute indirectly to the settlement of charges. Any such indirect effects would, however, depend in part on the impact of the use of the currency on the external position of the member whose currency is used.

The sale of a member's currency by the Fund in financing a purchase, with an exchange to a freely convertible currency at the request of the purchasing member, would result in an immediate reduction in the foreign exchange holdings of the member in arrears. If the currency is used (by the purchaser, the Fund, or any other entity) to finance expenditures that would otherwise have been made in foreign exchange or in local currency obtained with foreign exchange, the result would be a reduction (which may, however, be spread out over a somewhat longer period) in receipts of foreign exchange by the member. If the currency is held by the purchaser, there would be no offsetting impact on the member's gross foreign exchange position, although there would be a shift in the member's liabilities from the Fund to the purchaser.

Except in this latter case, therefore, the use of a member's currency by the Fund would result in a corresponding reduction in the availability of foreign exchange to the member in arrears and would not be expected, by itself, to strengthen the member's ability to meet remaining financial obligations to the Fund. In essence, the net foreign asset position of the central bank would be unchanged, and there would be no economic effect unless the purchase of the currency of the member in

arrears led to a demand for that country's output that otherwise would not have been made. This is an unlikely event. In contrast, the acquisition and holding of the member's currency by other members would tend to alleviate pressure on the member's external position, though the importance of this effect and the extent to which it was more than temporary would depend importantly on the terms agreed for any liquidation of those holdings.

With respect to the member acquiring the currency of a member in arrears, the effect would depend on the nature and purpose of the acquisition. If the currency were acquired and exchanged or sold at the same (equal value) rate of exchange, the only effect would be on the composition of the member's reserves. If the currency were used in lieu of foreign exchange to finance local payments, and assuming that the exchange rate at which it acquired the currency corresponded to rates otherwise available, ^{1/} the acquisition would have no net effect on the purchaser's foreign exchange holdings. The purchaser would, however, be exposed to exchange risk on the balance acquired and held for any period prior to the expenditure. If the balances were acquired in order to be held, the purchaser's holdings of usable reserves would be reduced, and the holder would be exposed to exchange risk, unless an exchange guarantee were provided by the issuing member, and perhaps a risk of non-payment.

IV. Some Operational Considerations

In the event the Fund were to pursue an effort to use the currencies of members in arrears, a number of technical and operational questions would need to be considered. This section briefly sets out some of the main questions.

1. Representative rates

All exchanges of currencies between the Fund and members are conducted at an exchange rate between two currencies corresponding to their exchange rates in terms of the SDR. The value of a currency other than the U.S. dollar in terms of the SDR is determined on the basis of the value of the U.S. dollar in terms of the SDR and the representative rate of exchange, the definition of which is discussed with a member upon joining the Fund and is subsequently approved by the Executive Board. The Board's decision in this respect normally incorporates an understanding that the member is to inform the Fund of any change in the representative rate. The rate is adjusted, if indeed there is a change, when the currency is used in a Fund operation or transaction and, in any event, at least once a year at the close of the Fund's financial year for the purpose of valuation adjustments to the Fund's holdings of a member's currency.

^{1/} The question of representative rates is discussed further below.

How close the representative rate is to other exchange rates that might apply to foreign exchange transactions is of importance both to the Fund and (unless the currency purchased is to be exchanged immediately at the equal value rate) to a potential purchaser of a currency. The representative rate determines the value of the Fund's holdings and would determine the SDR value of the reduction of holdings associated with a particular use of currency. From the purchasing member's point of view, if use in local currency expenses is anticipated, a purchase from the Fund is not likely to take place unless the Fund's rate is very close to, or more beneficial than, rates that may be obtained otherwise. In the event that a transaction involving the currency of a member in arrears were to be made, it would be necessary to examine closely the representative rate for the member concerned, to determine whether it reflected market conditions and approximated rates that might otherwise be obtained by purchasing members.

2. Currencies to be used

During the Board discussion in June 1986, the suggestion for currency use was made primarily with reference to members declared ineligible to use the Fund's general resources. The Fund is not, however, limited legally to the use of the currencies of these members and could, for example, offer to sell the currency of any member that was in arrears on a repurchase obligation, any member that was subject to a complaint with respect to such an obligation, or any member that had been overdue on repurchase obligations for a certain period of time, after consultation with the member and provision of a reasonable opportunity to make the repurchase.

3. Amounts to be used or offered

It would also be necessary to develop criteria for determining the amounts of each member's currency that would be used or offered for sale. Such criteria could include, for example, factors related to the size and duration of the member's arrears, its progress in settling the arrears to the Fund, and the prospects for future payment.

4. Attribution of reduction in the Fund's holdings of currencies

As noted, members are free to attribute a reduction in the Fund's holdings of their currencies to any of their repurchase obligations and (subject to limitations) to enlarge their reserve tranche positions. It would be necessary for the Fund to decide that a reduction resulting from sales or use by the Fund of the currency of a member in arrears would be attributed to that member's overdue repurchase obligations and to determine the order of the obligations to be settled in this way.

V. Concluding Remarks

1. In response to a request by the Executive Board, this paper has given consideration to certain questions relating to the possible use by the Fund of its holdings of the currencies of members in arrears to the Fund.

2. Legal authority exists for:

(i) sales to other members in exchange for their currencies, subject to the general provision of Article V, Section 3(d), or the special provision of Article V, Section 7(h), on the selection of currencies by the Fund. Article V, Section 7(h), with respect to the sale of holdings of a member's currency that the member has failed to repurchase, obviates the need for the Fund of finding that the balance of payments and reserve position of a member is sufficiently strong. Furthermore, under either provision, the sale by the Fund is not subject to agreement with the issuing member. Difficulties may, however, arise when an exchange requested by the purchasing member under Article V, Section 3(e)(i) at the time of the purchase is not made. The Fund must either refrain from selling the currency or substitute another currency for the currency that the issuing member has failed to exchange. The Fund could consider adopting policies under Article V, Section 7(h) limited to circumstances in which the purchasing member could either use the currency or obtain an exchange;

(ii) sales to other members or prescribed holders in exchange for SDRs. In both cases the Fund may not require the participant or prescribed holder to enter into such transaction. Furthermore, the concurrence of the issuing member would be necessary;

(iii) other uses such as payments of administrative expenditures.

No authority exists for sales of currencies in the market by the Fund except after withdrawal of a member.

3. The possibility exists that sale or use by the Fund of currencies by these methods might create an additional means of channeling payments to the Fund, if the overdue member and other members were prepared to participate. However, for the most part these mechanisms would not in themselves improve the balance of payments position of the member in arrears and would normally involve a transfer of, or failure to receive, foreign exchange resources by the member, with a corresponding transfer of resources to the Fund. If the member were willing to pay, it could be argued that in most cases this transfer might be more straightforwardly effected by other means, such as direct payment by the member with resources acquired through exports or other current receipts or through aid donations or creditor financing.

On the other hand, use of these provisions could provide some additional scope through which the collaborative efforts of the membership to deal with the problem of overdue financial obligations to the Fund could be brought to bear. Insofar as this vehicle could enable resources to be mobilized that might otherwise not be available, it could strengthen members' efforts to service their debt to the Fund. The practicality of these means would need to be explored on a case-by-case basis.

4. In the case of a member which does not appear willing to collaborate with the Fund, even though it is judged to have sufficient resources, it is for consideration whether the Fund should offer the member's currency in financing purchases, with provision of a "fail-safe" mechanism to protect the purchasing member. While the staff would not predict that such a policy would lead to a significant reduction in the Fund's holdings of the currencies of members in arrears, it may nevertheless be valuable as a further formal technique that could be considered after other procedures have been exhausted, and it would be an additional means of judging a member's willingness to cooperate with the Fund following a declaration of ineligibility. The staff would welcome the guidance of Executive Directors in this respect.

5. On the more technical question of how to proceed in making use of the currencies of members in arrears to the Fund, the following considerations are of relevance.

(a) As regards using these currencies to finance purchases by other members, it is for consideration whether the Fund should make such use only in circumstances where there is (i) a firm assurance on the part of the issuing member that the currency would be exchanged promptly, at equal value, if requested; or (ii) an indication by the purchaser that it wishes to obtain the currency from the Fund without seeking exchange.

(b) The possibility of sales to other members or prescribed holders in exchange for SDRs would seem to offer a potentially wider range of demands for the currencies of members in arrears, including:

- (i) use by other members in financing transactions (e.g., for trade, aid, and diplomatic purposes) in and with the country in arrears;
- (ii) use by other institutions (e.g., to finance local costs of development assistance projects), which could in some cases require the intermediation of Fund members in conducting the sales; and
- (iii) acquisition by other members as a technique of assisting the member in arrears to become current and of cooperating with the Fund in dealing with the problem of overdue obligations.

As noted, however, any such sales in exchange for SDRs would require the concurrence of both the member in arrears and the purchaser of the currency, and that of another institution if a "triangular" arrangement were involved.

(c) In considering whether to pursue these possibilities it would be important to have the views of Executive Directors on all these points and, in particular, on whether the countries they represent would be prepared, as may be the case, to permit their currencies to be sold or to purchase the currencies of members in arrears. The Board's guidance is also required on the question whether the staff should pursue discussions with other institutions on their possible needs for currencies concerned and their potential willingness to acquire those currencies in transactions arranged through the Fund.

6. Quantification of the amounts that might be involved in sales of the currencies of members in arrears is difficult, and it may not be possible to be very precise in this respect without extensive further analysis and detailed consultations with the other parties to such transactions (purchasing and selling members, Fund creditors, other institutions). If Executive Directors could identify specific possibilities that they would support and would regard as worth exploring, it would help to focus the required analyses and consultations.

7. With respect to Fund administrative expenses, very minor amounts of the currencies of some countries in arrears have been used in the recent past and there would appear to be some scope for an increase in use. However, the potential amounts are very small in absolute terms and in relation to the obligations outstanding, and use of local currencies would give rise to some administrative inconvenience. If Executive Directors wish greater emphasis to be given to use of these currencies in administrative expenditures, the staff would suggest that for administrative reasons the effort be confined mainly to any large individual outlays that could be made in local currency.

8. In considering whether to pursue further the idea of using the currencies of members in arrears, Executive Directors will wish to bear in mind the effects of such use on the members' external positions, as discussed in Section III above, the needs for consultation and concurrence associated with certain uses, and the views of others as to the preparedness of their authorities to permit, and to participate in, sales by the Fund of the currencies of members in arrears. Specific indications by Executive Directors that their authorities would be willing to support and participate in such sales would be important in determining whether this approach would be potentially effective and meaningful as a technique of reducing arrears.



Office Memorandum

Mr. Finch
B

TO: ETR Economist *B*

FROM: Peter J. Quirk *P.*

SUBJECT: Information on External Payments Arrears *P.*

December 1, 1986

A request has been made by an Executive Director, and agreed to by Management, that available information on external payments arrears to official and unofficial creditors be quickly compiled and issued as a supplement to the recent Executive Board paper on arrears. ^{1/} To enable us to meet this request, please complete the entries in the attached table relating to those countries for which you are responsible (indicated in top right-hand corner of this memorandum). The entries should be footnoted on your copy to indicate the form of the negotiations for the restructuring of the arrears (official and unofficial separately) that are presently underway, or are expected to commence shortly.

Please direct any questions that you may have, and provide the completed entries and footnote on your copy of the table, to Ms. Jul (ext. 8524) by c.o.b. Wednesday, December 3.

Attachment

cc: Mr. Finch ✓
ETR Divisions

^{1/} "External Payments Arrears of Fund Members, 1985-86," (EBS/86/261, 11/24/86).

External Payments Arrears of Fund Members,
by Type of Creditor

Member Country	1985 ^{1/}		1986 ^{1/}	
	Official Creditors	Other Creditors ^{2/}	Official Creditors	Other Creditors ^{2/}
<hr/>				

^{1/} Most recent data available [corresponding to Table 1 in EBS/86/261--copy attached].

^{2/} Including officially guaranteed private sector obligations in arrears.

Table 1. External Payments Arrears Outstanding, 1976-1986 1/
(In millions of SDRs; end of period)

	1976	1977	1978	1979	1980	1981	1982	1983	1984	1985 2/	1986 2/	1985 Arrears as percentage of 1984 Imports
Afghanistan					x	x	x	x	x	x	x	...
Antigua and Barbuda	—	—	—	1	2	3	8	14	19	21	...	14
Argentina*	—	—	—	—	—	—	6,590	13,105	19,674	1,493	...	32
Belize*	—	—	—	—	—	—	—	5	6	—	—	—
Benin	...	—	—	22	—	—	11	49	89	156	169	64
Bolivia	—	—	—	12	126	104	228	438	727	922	980	200
Brazil	—	—	—	—	—	—	—	2,235	—	2,094	2,650	17
Burkina Faso	—	—	—	—	—	13	25	27	37	64	...	33
Central African Republic*	35	39	8	42	63	43	45	28	12	4	—	3
Chad	9	9	5	4	9	37	42	48	51	55	60	46
Comoros	—	—	—	—	—	1	1	2	3	4	...	13
Congo	4	4	23	31	14	34	30	62	97	212	175	33
Costa Rica*	—	—	—	—	234	565	1,007	38	219	30	109	3
Côte d'Ivoire*	—	—	—	—	—	—	—	174	53	—	—	—
Dominican Republic*	11	—	—	17	37	54	165	137	501	151	...	10
Ecuador*	—	—	—	—	—	—	191	97	60	—	—	—
Egypt	312	862	—	—	—	—	—	—	...	3,173	...	29
El Salvador	—	—	—	—	45	80	80	53	99	87	29	10
Equatorial Guinea*	—	—	—	—	—	2	9	20	43	29	1	81
Gabon	—	430	339	—	—	—	—	—	—	—	...	—
The Gambia	—	—	—	—	9	20	12	43	52	54	79	57
Ghana*	192	201	393	324	269	440	524	420	237	159	178	26
Grenada	x	x	2	1	—	—	—	1	1	1	...	2
Guatemala	—	—	—	—	—	—	261	273	500	533	498	46
Guinea	90	119	151	90	87	123	177	225	287	346	191	87
Guinea-Bissau	7	7	8	5	2	5	9	14	18	24	32	40
Guyana	—	27	17	22	34	101	230	391	546	643	774	300
Haiti	—	—	—	—	—	18	19	9	3	11	...	3
Honduras	—	—	—	—	—	12	52	99	172	188	172	22
Jamaica*	—	22	48	42	89	39	—	86	112	101	59	9
Liberia*	—	—	—	—	—	10	2	14	22	86	179	21
Madagascar*	5	7	11	13	175	103	213	96	81	73	...	20
Mali*	—	11	18	27	38	54	31	9	—	4	—	2
Mauritania*	x	9	23	15	28	20	37	59	107	—	—	—
Mexico	—	—	—	—	—	—	1,240	267	—	—	...	—
Morocco*	—	—	—	—	—	—	253	—	127	224	436	6
Mozambique	—	—	—	—	—	—	—	285	751	838	1,325	155
Nicaragua	—	—	58	363	621	453	393	489	641	633	...	87
Nigeria	—	—	—	—	—	—	1,948	4,360	4,903	3,861	...	48
Paraguay	—	—	—	—	—	—	—	86	94	145	...	13
Peru	...	...	115	—	—	—	—	21	1,420	2,585	4,639	115
Philippines*	—	—	—	—	—	—	—	1,565	2,744	—	—	—
Poland	...	...	...	...	...	...	...	...	...	660	764	—
Romania	—	—	—	—	—	981	352	—	—	—	85	—
St. Lucia	—	—	—	—	—	—	—	x	1	1	...	1
Sao Tomé & Príncipe	—	—	—	—	—	9	8	9	6	11	9	39
Senegal*	—	—	—	—	7	12	—	—	—	26	—	3
Sierra Leone	4	15	25	39	55	113	200	240	236	272	315	192
Somalia	—	—	—	13	35	40	50	79	120	42	65	10
South Africa	—	—	—	—	—	—	—	—	—	6,094	7,850	28
Sudan	241	572	597	878	848	1,293	1,428	1,121	963	1,599	...	120
Suriname	—	—	—	—	—	—	—	—	44	61	...	17
Tanzania	4	2	55	126	254	294	364	516	709	892	...	103
Togo*	—	8	34	21	22	64	162	1	4	—	—	—
Turkey	202	1,710	1,523	1,769	1,266	275	—	—	—	—	—	—
Uganda	29	21	63	68	172	130	113	75	60	72	...	15
Venezuela	—	—	—	—	—	—	748	3,916	4,489	4,827	4,864	38
Viet Nam	—	—	—	—	—	33	224	380	582	508	670	28
Western Samoa	—	—	—	—	1	9	13	3	2	1	1	2
Yugoslavia*	—	—	—	—	—	—	295	—	—	1,477	...	15
Zaire*	385	671	950	1,118	450	530	848	372	181	101	59	15
Zambia*	223	394	496	351	461	500	725	597	568	572	513	81
Total	1,753	5,140	4,962	5,414	5,453	6,617	19,353	32,653	42,473	36,200	...	...
Memorandum item:												
Aggregate amount resched- uled in each year 3/	334	457	2,222	4,462	3,769	1,893	5,525	67,585	37,491	118,517	...	...

Sources: National authorities and Fund staff estimates.

1/ The table shows data on countries known to have had external payments arrears in any year during the period 1976-1986 or other dates indicated in the footnotes. Defaults, i.e., payments arrears incurred by governments participating in common central bank arrangements (Bank of Central African States (BEAC), Central Bank of West African States (CBOAO), and Eastern Caribbean Central Bank (ECCB)) resulting from the government's inability to obtain domestic currency with which to purchase needed foreign exchange from the common central bank, as well as those incurred by the government or a government entity whose financial operations form part of the budgetary process, are included in these figures. In the former case, since it is not possible to distinguish between domestic and external arrears, total arrears are shown.

2/ Most recent estimates available; where end-year data are not available, data at the end of the most recent period are used to arrive at totals.

3/ Amounts are with respect to Fund member creditors and include rescheduling of arrears and service obligations not yet due.

Symbols: * Financial program supported by use of Fund resources in effect in December 1985 (including arrangements under which purchases have been suspended). x Arrears less than SDR 0.5 million.



Office Memorandum

CC: ~~Mr. Guitián~~
Mr. Guitián
OK
PDE
Nov 26, 1986

TO: The Acting Managing Director

November 26, 1986

FROM: Manuel Guitián *MG*

SUBJECT: External Payments Arrears: Mr. Kafka's Enquiry

This note is in response to Mr. Kafka's enquiry regarding the data for members' external payments arrears contained in the Executive Board paper issued on Monday 1/.

In this series of papers we have provided data that has stemmed from the exercise of Fund policies under stand-by and EFF arrangements, and for jurisdiction under Articles VIII and XIV. These policies have not generally hinged on the particular distinction between official and other creditors (Brazil's arrears are all with respect to official creditors) in which Mr. Kafka is interested. However, we have been attempting to extend the reach of the data, and this year's report contains for the first time some country series on changes in arrears disaggregated by means of settlement (cash payments and rescheduling). As I mentioned over the telephone, if it was thought to be generally useful, the possibility of a further extension to available data on official versus other creditors could be examined.

As you know, the data on arrears are difficult to compile because they do not stem from standard balance of payments documentation. There is therefore a necessary qualification to be made on further disaggregating the data: it concerns the quality and the coverage of the data, which is likely to be limited. As you have suggested, in response to Mr. Kafka's concerns, we will compile the available data on arrears against official and other creditors with a view to issuance as a supplement to EBS/86/261.

If you agree, I will so inform Mr. Kafka.

Quirk

1986 NOV 26 PM 5:25

OFFICE OF THE
DEPUTY MANAGING DIRECTOR

1/ "External Payments Arrears of Fund Members, 1985/86" (EBS/86/261, 11/24/86).



Office Memorandum

TO: Mr. Habermeier

FROM: C. David Finch *CP*

SUBJECT: Sale and Use of Currencies of
Members in Arrears to the Fund

ms

P

November 12, 1986

B

In response to the request for comments on this draft Executive Board paper, we would have the following main suggestions:

First, in our view the major determinant of the feasibility of the currency or SDR transactions will be the attractiveness of the transactions reflecting the implicit exchange rates. We believe that the draft should give more emphasis to this than to the General Account/SDR assymetries. It should also go further in assessing the constraint imposed by Article XIX on implicit multiple rates.

Second, we wonder if it would be productive at this stage to identify potential transactors. The suitability of these instruments would probably best be established on a case-by-case base, with this paper establishing their availability.

For more background on these points, and some additional comments, please see Mr. Quirk's note (attached).

cc: Mr. Gianviti



Office Memorandum

TO: Mr. Finch

November 12, 1986

FROM: Peter J. Quirk

SUBJECT: Sale or Use of Currencies of Members in Arrears to the Fund--Preliminary Considerations

The following are comments on the draft paper for Executive Board discussion circulated on November 10, 1986. As in the draft, general comments are separated here on the basis of the legal and practical issues; they are followed by some more detailed suggestions.

Legality

The draft paper is generally negative with respect to the possibilities for sales of currencies of members in arrears, while concluding that the exchange of such currencies for SDRs is legally feasible. Two main reasons for this asymmetry are stated:

1. From the point of view of the purchaser, it is noted that the requirements of Article V, Section 3(b) relating to the purchaser's BOP need must be met. "The fact that the currency provided could be used by the member would not be sufficient" (page 4, second paragraph).

2. From the standpoint of the seller, observing the obligation to exchange on request for a freely usable currency under Article V, Section 3(e) is necessary for the transaction to take place (page 12, second full paragraph).

However, it is not clear that these necessarily constitute impediments to the use of the General Account. Article V, Section 3(b) states that it applies to members requesting "to purchase the currencies of other members from the Fund in exchange for an equivalent amount of its own currency" (underlining added). Should the purchase be effected in currencies other than the member's itself, then this bar to sales would not be applicable. Such an approach (if feasible) would be consistent with the aim of the purchasing member of using the Fund to affect the composition of its assets (and those of the Fund), rather than to draw for its own BOP support.

With respect to the second constraint under Article V, Section 3(e), that imposed on the potential seller, there is the specific provision of Article V Section 3(e)(iii) whereby the members concerned do not request exchange for other currencies, "but agree on another procedure." (e.g. exchange for non-currency assets).

In practice, the constraint on both General Account and SDR transactions therefore seems most likely to arise from exchange rate considerations. If the exchange is for currencies, avoidance of

effective multiple exchange rates (under Article XIX) would probably preclude voluntary purchase or exchange for SDR's (at the official or representation rate). However, exchange for non-currency assets (e.g. equity in the seller's territories) could in some situations be considered profitable by the purchaser without necessarily involving an implicitly different effective exchange rate. The paper should note that the determination under Article XIX, Section 7 that the transaction should lead to the "same value whatever currencies should be provided" would presumably be made by the Fund, and would extend also to exchange of a currency or SDR's for non-currency assets. The underlying consideration of the exchange rate requirements of Article XIX, Section 7(a) should be stated with more force to qualify the conclusion on page 19, "that it is legally possible for the Fund to sell, to a prescribed holder, in exchange for SDRs, the currency of a member in arrears to the Fund."

Practicality

This section in part mirrors the conclusions of the legal section regarding the asymmetries in the use of General Account and SDR transactions. Adjustment is therefore suggested to reflect the comments above. It basically concludes that, even if engaged in, a large volume of such transactions would not be likely. However, any additions to the number of instruments available to deal with the important issue of Fund arrears, on a case-by-case basis, must be welcome. In view of the case-by-case approach, the time-consuming data collecting and consultation exercise referred to in paragraph 7 on page 35 would not seem useful.

As with the legal section, further discussion in this section of exchange rate considerations, and incentives for purchasers to enter into such transactions including use of non-currency assets, would be useful. From a practical perspective, the basic problem--that in utilizing any such mechanisms care should be taken not to weaken members' incentives to make repurchases on time--should be also dealt with in the conclusion.

Another point is that identification in the paper of recipient institutions such as the IBRD or IDA, on pages 24 and 25, could be viewed as an overt attempt on the part of the Fund to shed its problems, and could be counterproductive, particularly where the member already has arrears to the institutions.

Page 7, first full paragraph. It should be mentioned here that considerations of the "Fund's financial position, and the Fund's liquidity" are specifically cited as grounds for sales of currencies in paragraph 4 of Decision No. 6774.

Page 10, footnote: The linkages to ineligibility and quota increases are put somewhat too categorically.

Page 13, second and third paragraphs: The relevance of these

paragraphs is unclear--could these adjustments have practical effects on the incentives for use or sales of currencies?

Page 26, full paragraph: It is not readily apparent why the local currency component of resident representative expenses should be small.

Page 28, first paragraph: Use of the purchased currency to acquire real assets (e.g. equity) could be considered here.



Office Memorandum

Mr. Finch

W

W

B

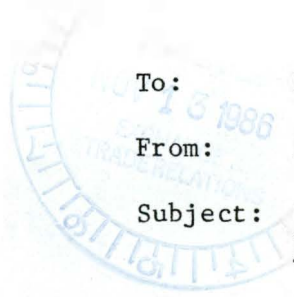
A

To: Mr. Peter Quirk

From: Aarno Liuksila *W*

Subject: External Payments Arrears of Fund Members, 1985-86

November 12, 1986



While the inclusion of the standard jurisdictional footnote 1/ on page 2 of your draft report remains appropriate without change from previous years, the jurisdictional footnote 1/ on page 3 and the jurisdictional footnote 1/ on page 10 are not accurate in their present form. For instance, the footnote on page 3 does not explain that the "temporary postponement" you have in mind is a "unilateral" postponement without consent by creditors. There are cases, as you know, where a temporary postponement of debt service involves a waiver of contractual rights by creditors pending rescheduling by agreement with each creditor and, therefore, such action by creditors has been taken as eliminating payments arrears under the policy-based definition of arrears. As this is an important aspect on policy on arrears, such actions taken under the auspices of the Paris Club or in creditor bank meetings, should be noted on page 7, seventh line, as eliminating arrears under the Fund policy but not exchange restrictions under Article VIII, Section 2(a). You may also wish to explain how the Fund polices the execution of individual agreements with each creditor pursuant to understandings reached with creditor groups. How did we treat the South Africa's stand-still arrangements with commercial bank creditors in this regard? On page 10, the footnote should be redrafted by changing "because" into "when" and by deleting the word "often" on the fourth line; insofar as arrears are attributable to a lack of domestic currency in the circumstances described, the arrears always evidence defaults and not restrictions.

I attach copies of pages of your draft report with drafting suggestions.

Attachments

cc: Mr. Finch
Mr. Gianviti
Mr. Holder



Office Memorandum

cc: B/F

ME

AB

TO: Mr. Anjaria

August 22, 1986

FROM: Markus Rodlauer *MR*

SUBJECT: External Arrears Clauses in Fund Arrangements

You asked whether external arrears clauses are usually formulated as "point" limits or as "continuous" or "running" ceilings. A quick check of the record indicates that the practice is not uniform; moreover, in a few cases it is not clear from the documents which form of ceiling is intended.

Arrears reduction clauses have usually been formulated as point limits and tested together with other performance criteria at end-quarter. In contrast, clauses stipulating the avoidance of new arrears have in most letters of intent/memoranda of understanding used language that would prohibit the incurrence of arrears at any time during the period of arrangement ("continuous ceiling"). However, in many of these cases, the customary table on performance criteria attached to the letter of intent, as well as the stand-by arrangement itself, formulate the performance criteria related to new arrears as quarterly point limits. Thus, in these cases the authorities have expressed (in the letter or the memorandum) an intention to avoid new arrears at any time; this intention, however, is to be monitored only quarterly. 1/ On the other hand, there are also a number of cases where the new arrears clause has been formulated consistently 2/ as a continuous ceiling (e.g., Ecuador, Mauritania, Niger).

The attached table lists the arrangements reviewed and their specific form of new arrears clause.

A few additional points.

1. First, we are not aware of any recent case where the temporary emergence (i.e., emergence and subsequent elimination between two test dates) of external arrears in violation of a no-new-arrears clause has prevented a purchase otherwise conditioned on performance at the end of the quarter (i.e., because such arrears by definition have been eliminated before the end of that same quarter). Likewise, we know of no case where a purchase could not be made because of the emergence of arrears after a quarterly test date, but before the purchase conditioned on that test date was actually effected. The latter case may have been prevented by the normal time lag between the actual incurrence of

1/ It should be noted, that in a few cases, the new arrears clause has been consistently (i.e., also in the letter of intent) formulated as a point ceiling to be tested quarterly (e.g., Côte d'Ivoire).

2/ I.e., also in the table on performance criteria and the SBA itself.

external payment arrears, and their surfacing to the knowledge of and verification by the Fund. 1/

2. The exact legal implications of a breach of a continuous ceiling is not straightforward. Would the member be precluded from purchasing only until the arrears are cleared, or until the observance of performance criteria at the next quarterly test date has been established, or until new understandings have been reached with the Fund?

3. The question of whether to formulate external arrears clauses as continuous ceilings or as point limits should be viewed in the context of the purpose of external arrears tests in general. The latter is broadly threefold: (i) to protect the meaningfulness of other performance criteria under the program, (ii) to encourage the authorities to keep their payments system clean of restrictions, and (iii) to preserve relations with creditors and the country's creditworthiness. For point (i), quarterly test dates should suffice if other performance criteria are on a quarterly basis; for point (ii), the authorities' genuine intention to avoid new arrears, a well-functioning institutional set-up that allows the prompt discharging of external payments obligations, and the customary injunctions against new or intensified restrictions may be more important than a continuous (vs. quarterly) ceiling on new arrears (which in addition may be difficult to monitor). Finally, although point (iii) may be very important, there is a question as to the degree of involvement that the Fund should seek in this area.

Attachment

cc: Mr. Brachet

1/ Paris Club creditors usually do not give signals about new arrears before a period of several months.

Table . Performance Criteria Relating to New Arrears

Country	Date of Arrangement	Formulation in			Comments
		Letter of intent/ memorandum of understanding	Table on performance criteria	Stand-by arrangement	
C.A.R.	9/23/85	No new arrears during 1986	Quarterly test dates	Quarterly test dates	
Ghana	8/27/84	No new arrears	Quarterly targets for net arrears reduction	Quarterly test dates	Only quarterly targets are performance criteria
Niger	12/5/85	Not...any new arrears in 1985/86	Quarterly test dates	Continuous ceiling	Table on performance criteria not included in letter of intent (only in staff report)
Liberia	9/14/83	Throughout 1983/84 no purchase... if new arrears occur	Quarterly targets for stock of arrears	Quarterly test dates	
Mauritania	4/21/86	No accumulation of any arrears during program period	Quarterly test dates	Continuous ceiling	Table on performance criteria not included in letter of intent (only in staff report)
Morocco	9/12/85	Not...any arrears (after end-September 1985)	Quarterly targets for stock of arrears	Continuous or point ceilings (?)	Text of SBA refers to "data for preceding quarter" instead of customary "end of preceding quarter"
Côte d'Ivoire	6/3/85	Quarterly limits on stock of arrears (zero)	Quarterly test dates	Quarterly test dates	
Côte d'Ivoire	6/23/86	Quarterly limits on stock of arrears (zero)	Quarterly test dates	Quarterly test dates	
Togo	6/9/86	Not...any new arrears during period of the SBA	Quarterly test dates	Quarterly test dates	
Ecuador	3/11/85	No new arrears during period of SBA	—	Continuous ceiling	
Dominican Rep.	4/15/85	No new arrears at any time in 1985 (performance criterion)	Quarterly targets for cash reduction	Quarterly targets	
Guatemala	8/31/83	Quarterly limits	Continuous ceiling	Continuous ceiling	



Office Memorandum

MR FINCH

RB W

TO: Mr. Quirk

August 19, 1986

FROM: S. Kanesa-Thanas *SK*

R

SUBJECT: Draft Paper on External Payments Arréars

The paper has two main parts. The first part (which covers about 18 pages) is more or less entirely factual reviewing the experience in the arrears situation (including treatment of arrears in Fund programs). It is a useful updating of data along the lines of earlier papers on payments arrears. The tables in the Appendix serve this function well. Textual comment on them should be limited and detailed references to individual country experience (e.g., under stand-by arrangements) should be avoided. Such an approach would help substantially to reduce the size of the paper.

The second part of the paper is described in the Introduction as dealing "with jurisdictional role of the Fund in rescheduling of members' arrears and with adaptations to members' exchange systems with the aim of eliminating or reducing arrears."

In my judgment, the subsection entitled "The Role of Jurisdiction" does not add anything significant in regard to the exercise of approval jurisdiction or to the linkage between Fund programs and reduction of arrears either through debt rescheduling or in cash. On the other hand, it contains a couple of sentences (pp. 21-22) which are at a minimum not clear--e.g., reference to "binding" nature of Fund approvals "which (therefore) ensure equality of treatment of Fund member country creditors" and the further reference to the implications of Fund's approval practices and policies to "confidentiality in Fund monitoring of a member's performance." (The latter appears to deal with something which has broader significance than in the context of arrears.)

As far as the section on "Exchange Policies" (which deals with specific devices such as foreign exchange retention accounts, escrows, incentives for equity investment, countertrade, leasing arrangements, etc.,) the discussion is in terms of their possible contribution or otherwise to overall balance of payments adjustment (which would, of course, help reduce arrears where they existed) rather than in terms of any direct linkages of such devices to arrears reduction. This is in fact acknowledged (in page 22) where it is said that the listed devices "are seen as complements and alternatives to adjustment in exchange rates and producer prices." I do not, therefore, feel that this section belongs in a paper on payments arrears.

Overall, it is my feeling that the paper should be limited to the first part as modified, and be issued only for the information of the Executive Board. Detailed comments are included in the attached copy of the paper.

Attachment

cc: Mr. Finch
Mr. Beveridge



Office Memorandum

cc: Mr. Bracket
Mr. Johnson

To: Mr. Beveridge ✓
Mr. Narvekar
Mr. Ouattara
Mr. Shaalan
Mr. Whittome
Mr. Wiesner

August 8, 1986

From: Vito Tanzi *Vito Tanzi*

Subject: Proposed Departmental Memorandum on Government Arrears

I want to express my appreciation for your thoughtful remarks on our draft study on government arrears. The problem of arrears is an issue which has important operational significance, and your comments will improve the clarity and analytical content of the paper.

I apologize for the tight deadline requested for comments on this paper. I agree that given the nature of the paper such a tight deadline was not essential. The reason was mainly to utilize a few available days for the authors before they become unavailable for a long time due to missions and leave.



Office Memorandum

cc: Mr. Bracher
Mr. Pockatton
Mr. Johnson

TO: Mr. Tanzi
FROM: A. D. Ouattara
SUBJECT: Proposed DM on Government Arrears

A. D. Ouattara

August 6, 1986

The proposed departmental memorandum on government arrears covers an important subject; as you know, arrears are unfortunately quite prevalent in many of the countries covered in this Department. As this subject has not yet been systematically reviewed, I believe this paper serves a very useful purpose. In particular, we are glad that the paper highlights in a frank way the enormous difficulties involved in defining and monitoring arrears. However, we would have liked to have somewhat more time available to provide comments, particularly as the proposed DM does not appear to have an urgent deadline.

Below please find some of our comments on the paper.

1. As the paper has a more practical than theoretical approach, it would have been preferable to have reviewed the pros and cons of methodologies used to measure arrears in some Fund programs and to propose a sound and, if possible, tested methodology to be used for programming purposes.

2. As for the preconditions referred to on page 40 for the use of arrears as a performance criterion, we would be inclined to add that the definition of arrears should be "as large and comprehensive as possible." The institutional and operational problems to be faced would certainly continue to exist with such a definition. It is, however, clear that most of the difficulties mentioned in the paper would be eased, as these difficulties arose mainly from the fact that arrears can exist at any stage in the expenditure process while the measure used for the performance criterion often captures only some of these stages.

3. The conclusion that "instituting a performance criterion on government arrears may be undesirable" causes us difficulties, largely due to the fact that the proposed drawback position would not solve the problem:

a. If the definition is as comprehensive as possible, most of the problems would be eased;

b. Monitoring broad aggregates of government expenditure poses, obviously, exactly the same problems as the ones posed by the monitoring of arrears, as the latter are included in the former;

c. Discarding the performance criterion on government arrears would also make the criterion on net credit to the Government difficult to enforce;

d. Considerations on possible "creative and inventive accounting" apply to all performance criteria, and the arguments presented in the paper seem to be more directed against the use of quarterly performance criteria and for their replacement than related to the arrears issue.

4. It is certainly desirable for a Government not to run into arrears. Another practical problem which has been debated is to know if, when a Government is already faced with a large amount of outstanding domestic arrears, a Fund-supported program should give priority to their clearance. It has sometimes been argued that this should not be the case due to the potential indirect negative impact on the balance of payments; this problem has arisen in some French franc area countries. It would have been useful to review this problem.

5. The statement on pages 10-11 that, in the French system, "commitments are generally proposed by the spending agency and usually without the approval of the Ministry of Finance" seems inaccurate. One of the key features of this system is the "control a priori" and the double responsibility of the spending agency and the Ministry of Finance at the commitment level. The Ministry of Finance has a representative in all spending agencies who has to approve all proposed commitments in order to ensure that they are in agreement with the budget allocations. The most important financial document a Minister of Finance is using to monitor the budget implementation is the commitment status (état des engagements) which is often issued on a daily basis. When the rhythm of commitment is too rapid, the Minister would ask his representatives in the spending agencies to slow down the commitment approval. If that were not the case, the problem of expenditure to be regularized (mentioned on page 15) would not exist.

cc: Mr. Finch
Mr. Hood
Mr. Narvekar
Mr. Shaalan
Mr. Whittome
Mr. Wiesner



Office Memorandum

oh lunch
Mr. Guician
cc: Mr. Beckett
Mr. Johnson

To: Mr. Tanzi

July 30, 1986

From: L. A. Whittome *LA*

Subject: Proposed Departmental Memorandum on Government Arrears

Arrears are clearly a complex area of government accounts and are most difficult to define and monitor. The draft paper is particularly useful in describing these complexities and the reasons for them. Equally, the description of the economic implications of government arrears is fairly discussed, although in a few places we have some minor differences with the draft.

Our major problem relates to Section VII and the relevant part of the conclusions dealing with arrears in Fund programs. These sections make it abundantly clear how difficult it is to measure and monitor arrears, a point with which we can agree. However, it moves from this easily defensible premise to the conclusion that a performance criterion on arrears "may be undesirable, since it may tend to put pressure on the authorities to subvert established accounting procedures" (page 50). It is recommended that the arrears problem be dealt with by "an appropriate monitoring system for broad aggregates of government expenditures with targets subject to the usual mid-term review" (page 50). These conclusions cause us some difficulty.

First, meeting agreed targets for expenditure will not by itself achieve any particular result for arrears since the latter depend on what happens to revenue as well as expenditure. Second, we are not at all sure that targets for expenditure, which act as performance criteria, will put any less pressure on the authorities to "subvert established accounting procedures." It may well be that in the arithmetic sense, there is more scope in a budgetary system to prevent the emergence of measured arrears by "inventive accounting." However, there is ample scope for such accounting to juggle with expenditures, for example, by changes in timing to meet performance criteria when there is an underlying deviation from the program. We would argue that the difficulties in implementing performance criteria on arrears are not inherently different than those in implementing expenditure ceilings. Indeed, the subversion of established accounting procedures can be a problem--and in one instance in a program with a country in this department has been a problem--in even such an apparently simple performance criterion as a ceiling on government borrowing from the central bank. The "pressure to subvert" exists not because of the particular form of performance criterion but its simple existence, although the more complex the accounting system the more the scope for creative accountants.

A few minor points. The second sentence on page 33 is correct only if the commercial banks cannot use government obligations to satisfy reserve requirements. In some countries they can do so. In the third sentence of the first full paragraph of page 34, "monetary creation" is surely used too broadly. M1 or M2, for example, would not include government checks. On page 36, the first full paragraph in our view greatly underestimates the speed with which arrears affect the credit rating of a country.

cc: Mr. Finch
Mr. Hood
Mr. Narvekar
Mr. Ouattara
Mr. Shaalan
Mr. Wiesner



Office Memorandum

cc: Mr. Brauer
Ms. Puckartkow

NP

1
M

TO: Mr. Tanzi

July 31, 1986

FROM: P. R. Narvekar *PRN*

SUBJECT: Proposed DM on Government Arrears

Attached please find Mr. Smith's memo (July 30) commenting on the proposed DM. I believe his comments would be useful to the authors. Mr. Smith refers, by way of background, to our experience with government arrears in one Asian country. I agree that the paper might be strengthened by giving an indication of actual experiences but clearly explicit references to countries would be inappropriate in a research paper likely to be widely circulated. Indeed, in this light, you may want to consider omitting Table 1, which provides detailed data on arrears for particular countries with Fund programs.

cc: Mr. Finch ✓
Mr. Hood
Mr. Ouattara
Mr. Shaalan
Mr. Whittome
Mr. Wiesner



Attachment



Office Memorandum

TO: Mr. Otani

July 30, 1986

FROM: Bruce J. Smith *BJS*

SUBJECT: Government Arrears in Fund Adjustment Programs

This paper addresses an interesting topic and serves a useful purpose by drawing our attention to a particular problem that, perhaps, has not received an adequate airing in the past. However, as a general comment, I think the paper is overwritten and its substance could well be contained in half the length. Also, its focus and analysis are rather too general in addressing the identification problem, presentation, and the economic effects; I would have preferred to see more concrete cases cited.

In thinking about the subject, it seemed to me that there could be probably two types of problems of this sort: one in which the government becomes substantially delinquent in its payments and the second where it temporarily delays payments for a few days, perhaps as a way of getting around Fund performance criteria. A major gap in the paper to my way of thinking is that it doesn't address the Fund's experience with payments delays to let us know which of these situations exists and how serious these problems have been. If they are of the first kind, then they are certainly more serious in their economic effects, although perhaps their identification may be easier. I have a feeling though that the more common experience is with temporary delays and postponements.

Certainly we were aware in one multiperiod program with a country in this Department that there was scope for the authorities to manipulate payments' patterns to meet credit ceilings. In fact, they made no attempt to hide their activity in this area from us. We did not see it as a major problem for two particular reasons. First, in a multiperiod program, the postponing of payments from one period to the next also transfers the problem from one period to the next so that unless the government is prepared to go on increasing the level of arrears, which is very difficult, sooner or later the credit ceilings and measures of fiscal deficits will catch up with reality. Second, most governments would be reluctant to appear to be defaulting on their obligations to suppliers or under Fund programs, so that whereas they may be willing to juggle the books slightly, they would think hard before they made major identifiable delays in payments that would be economically significant just to avoid performance criteria.



Office Memorandum

Mr. Finch
Mr. Bracker
Mr. Johnson

TO: Mr. Tanzi

July 31, 1986

FROM: A.S. Shaalan *AS*

SUBJECT: Proposed Departmental Memorandum on Government Arrears

I fully agree with you that this is an important subject which has not as yet been systematically reviewed in the Fund. The importance and implications of budgetary arrears are likely to grow for economic policy formulation in developing countries burdened with heavy debt. Keeping in view the importance of the subject matter for the formulation and monitoring of Fund-supported adjustment programs, and the fact that the paper is being prepared as a DM, I am giving below rather detailed comments aimed at improving the focus, organization, analytical contents, and operational significance of the paper. I may suggest in passing that for a paper like this, which does not have a management- or Board-dictated deadline for completion, it would help improve the quality of comments if more time could be given for review.

The paper rightly points out the conceptual and statistical problems in defining and measuring budgetary arrears. However, the usefulness of the paper could be enhanced by evolving a more adequate conceptual framework for developing a definition of "arrears" and "government," and discussing both statistical methods for measurement and sources of data. Unless we are able to develop operationally meaningful concepts of arrears and government, and evolve techniques for measurement and quantification, the theoretical discussion of the problem will have rather limited usefulness for the formulation and monitoring of economic adjustment programs. In this light, the focus of the paper could be enhanced if section I is expanded to include an attempt to develop an operational definition of "arrears" and "government," and techniques to measure such arrears. As regards sections II and III, relating to the "accounting" sources of the problem, these provide useful descriptive material that can be given in a technical appendix. In its present form the material does not deserve to be given the prominence in the main paper that it has now, as it distracts the reader from the more fundamental issue of budgetary arrears and their implications.

There are various ways to classify arrears and to trace their monetary, budgetary and economic impact. While I found the distinction between "expenditure arrears," "interest arrears," and "amortization arrears" quite interesting, the paper should, however, make it clear that "expenditure arrears" cannot last for a long time nor can those be accumulated indefinitely; suppliers will refuse to provide "goods and services" beyond a certain point of nonpayment. Similarly, in discussing the impact on prices occasioned by the incurrence of these arrears, equal attention should be devoted to the attempts by governments to engage in interest free borrowing from central banks to

clear such arrears, which is highly inflationary. The more important forms of arrears, of course, relate to interest and amortization. In my view it will be very useful to develop a more comprehensive and systematic framework of analysis of each type of arrears for (a) prospects for reducing budget deficit, (b) monitoring of credit ceilings, (c) fulfilling the monetary targets, (d) affecting the rate of inflation, and (e) achieving financial stability and economic growth.

It is equally important that the paper analyze the origin of arrears, i.e., emergence of arrears due to shortfalls in revenues, shortfalls in foreign receipts including aid, and overshooting of other expenditures. In this context, a more careful delineation between external and domestic arrears, and a more comprehensive analysis of the former are in order. The question of external arrears is closely tied-up with the balance of payments problem and net resource transfers from abroad. The budgetary implications of external arrears, as well as their monetary and economic impact, could be quite different from those of domestic arrears. Moreover, resolution of the problem of external arrears from the point of view of foreign exchange can be separated from that from the budgetary point of view. It is in this context in which the discussion on "blocked" accounts and their treatment in monetary and budgetary analyses should be placed. Moreover, it would be useful to examine in depth the effectiveness of blocked accounts as an instrument of financial and monetary management. Similarly, the prerequisites for a successful utilization of blocked accounts could be spelled out. Finally, I feel that other issues, including the treatment of arrears subject to rescheduling and the options available for treating debt relief, could also be covered. The latter analysis would be especially appropriate in the context of the discussion on blocked accounts.

I am also inclined to suggest that the ex post analysis of arrears be separated from their ex ante analysis. The formulation of a policy package must initially be based on meeting all internal and external payment obligations, resulting probably in the emergence of an ex ante financing gap in the budget. In filling the gap, rescheduling of debt, external cash and commodity aid, and internal revenue efforts would need to be tapped. In the context of a program developed in this manner, an attempt may have to be made to "sterilize" a part of the monetary impact of debt relief and/or cash and commodity aid. Similarly, the program will have to make explicit provision for treating any arrears that may emerge in the budgetary and monetary accounts during the program period. It is in this context that both the definition and technique of monitoring arrears assumes importance. While economic programming may not crucially depend on the availability of actual statistics on all the budgetary arrears, the monitoring of the program would indeed require the development of procedures to obtain information on emerging arrears.

Some of my colleagues in the department who have been dealing with the issue, will be glad to pursue the subject matter further, if the authors of the paper so desire.

cc: Mr. Finch
Mr. Hood
Mr. Narvekar
Mr. Ouattara
Mr. Whittome
Mr. Wiesner

7/29/56

rt

Mr. Finch,

The paper is fine.
It could stress more
the distinction between
domestic and external
areas. The authors
do not seem familiar
with our work on energy
and make no reference
to it. MB

Manuel Guitián



Office Memorandum

cc: Mr. Beach
Ms Puckatikon
comments

To: Mr. Finch
Mr. Hood
Mr. Narvekar
Mr. Ouattara
Mr. Shaalan
Mr. Whittome
Mr. Wiesner

July 25, 1986

From: Vito Tanzi *Vito Tanzi*

Subject: Proposed Departmental Memorandum on Government Arrears

Two members of our department have recently prepared a draft study on the problems associated with government arrears in Fund adjustment programs. This has become an important problem in many Fund programs and yet it is a topic which has not been systematically reviewed. I would be grateful for any comments that your Department might have by c.o.b. Thursday, July 31.

Attachment



INTERNATIONAL MONETARY FUND

Fiscal Affairs Department

Government Arrears in Fund Adjustment Programs

Prepared by Jack Diamond and Christian Schiller

Approved by Peter S. Heller

July 1986

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I. Introduction

In recent years, the emergence of delays in a government's payments to its suppliers and creditors, generally referred to as 'arrears,' has become an important issue in many developing countries. Given accounting conventions, the presence of arrears may lead to an underestimation of expenditure, and correspondingly of the impact of government operations and the size of the fiscal problem facing a country. Since arrears can be viewed as a form of forced financing to the government, the government's borrowing requirement may also be underestimated, yielding a distorted picture of the sources of credit expansion in an economy. The existence of arrears has also created problems in the context of Fund programs. When fiscal adjustment has been less than programmed or there have been unprogrammed shortfalls in other sources of financing, it has been found that a build-up of arrears has become a means for a country to comply with formal performance criteria in Fund programs with respect to limits on recorded government domestic bank financing. Such an unprogrammed accumulation in government arrears may circumvent the desired fiscal adjustment. As a result, Fund programs include clauses designed to limit and reduce arrears, so as to curb this policy option. 1/

1/ Of course, the Fund interest in foreign arrears transcends the immediate problems of particular members, being rooted in the concern of the Articles of Agreement in maintaining an open system of international trade and payments that avoids restrictions such as those implied by external arrears.

The objective of this paper is to gain a fuller appreciation of the significance of the government arrears problem, with particular emphasis on how the problem may be identified, quantified, presented in fiscal tables, and integrated into policies of fiscal adjustment. Section II provides data on the empirical significance of the arrears problem. Section III discusses the issues involved in defining and measuring arrears. To evaluate the impact of alternative types of arrears, Section IV provides a taxonomy of arrears according to the type of payment from which the arrear originates and the payee to whom the arrear is due. Section V suggests an approach for incorporating arrears into the presentation of government accounts. Section VI discusses the economic effects of arrears. After an examination of the significance of arrears in the context of Fund programs in Section VII, Section VIII provides some concluding remarks.

II. Quantitative Significance of Arrears

While arrears are known to be a prevalent problem in many developing countries, obtaining accurate data on the amount of arrears is extremely difficult. The reasons are discussed in Section III. Nevertheless, a brief description of the existing data on arrears may provide some evidence to illustrate the dimensions of the problem.

Government domestic arrears were factors of importance in the financial programs of at least 17 of the 66 countries which had Fund

programs during the period 1980 to mid-1985. ^{1/} Twelve of these countries were African, 2 were from the Western Hemisphere, 2 were European, and one Asian. It is not possible, due to problems of identification and quantification, to show the outstanding stock of government arrears in these countries. One can indicate those changes in arrears, both domestic and foreign, which have been quantified during the course of Fund programs, and these are shown in Table 1, relative to both total government expenditure and total government financing.

Considerable caution is required in appraising these data. The definition of arrears varies across countries, and it is likely that "identified" arrears understate the true magnitude of outstanding arrears. Even inter-temporal comparisons for any one country are difficult, as one often observes changes in coverage and definition as well as institutional changes in procedures for recording arrears.

Even with these caveats, the size and importance of the arrears problem can be appreciated from the statistics of Table 1. In 7 of the 14 countries shown in Table 1, changes in arrears have been the equivalent of 10 or more percentage points of total recorded expenditures. Such a change is likely to have a considerable impact on the rest of the economy, and yet it would not be discerned from the budget accounts conventionally used to measure the budget deficit. As a source of financing, the change in recorded arrears has been 10 percent or more of the total financing requirement of the government in at least one

^{1/} "Fund Supported Programs, Fiscal Policy, and the Distribution of Income," IMF, Occasional Paper No. 46 (forthcoming, September 1986).

Table 1. Relative Size of Government Arrears in Program Countries

Country	Year	Change in Identified Arrears as Percent of	
		Expenditure	Financing
Belize	1983/84	+3.0	+16.0
Central African Republic	1982	+0.5	+4.9
	1983	+2.1	+14.1
Côte d'Ivoire <u>1/</u>	1982	+2.2	+7.1
	1983	+10.1	+59.2
	1984	-7.0	-39.9
Liberia <u>2/</u>	1980/81	+1.9	+5.6
	1981/82	-1.6	-6.2
	1982/83	+2.1	+6.4
	1983/84	-2.1	-8.9
Madagascar <u>3/</u>	1980	-0.1	-0.2
	1981	-0.1	-0.3
	1982	-0.2	-0.5
	1983	-2.5	-8.2
	1984	-5.1	-23.9
Mali	1980	+4.0	+20.3
	1981	-1.2	-6.4
	1982	-10.4	-53.2
	1983	-9.7	-50.0
	1984	-4.9	-52.6
Morocco <u>4/</u>	1980	+1.1	+3.6
	1981	-0.5	-1.2
	1982	+6.3	+22.8
	1983	-7.7	-22.1
	1984	-0.9	-3.7
Niger	1979/80	+2.6	+9.1
	1980/81	+2.0	+4.6
	1981/82	+12.1	+47.1
	1982/83	-1.4	-3.5
	1983/84	-12.6	-29.0
Senegal	1979/80	+4.3	+35.0
	1980/81	+8.0	+28.4
	1981/82	-9.8	-28.0
	1982/83	+2.7	+10.2
	1983/84	-9.1	-32.9

Table 1. Relative Size of Government Arrears in Program Countries (concluded)

Country	Year	Identified Change in Arrears as Percent of	
		Expenditure	Financing
Sierra Leone	1980/81	+6.0	+15.8
	1981/82	+18.5	+42.3
	1982/83	-9.2	-15.4
	1983/84	+1.5	+3.5
Turkey <u>6/</u>	1980	+1.4	+6.8
	1981	+5.8	+100.0
	1982	-1.9	-16.6
	1983	+5.2	+53.5
	1984	+1.7	+6.6
Uganda <u>7/</u>	1980/81	+3.0	+4.1
	1981/82	+8.5	+26.0
	1982/83	+8.7	+32.1
	1983/84	-0.7	-32.4
Zambia	1980	+2.8	+9.6
	1981	-1.5	-4.1
	1982	-11.0	-22.7
	1983	+0.7	+3.0
	1984	+2.6	+11.5
Zaire	1982	+3.8	+12.5
	1983	+10.0	+109.2
	1984	+7.6	+171.1

Source: Staff estimates.

1/ Coverage relates to the nonfinancial public sector; also includes arrears on external amortization payments.

2/ Identified arrears up to 1984/85 include only arrears on interest. Expenditure up to 1984/85 is a mixture of checks issued and commitments, and deficits prior to this time may be underestimated because data on the accumulation of domestic arrears are unavailable. "Unallocated expenditures (net)" was 5.6 percent of the total cash deficit in 1980/81, 6.2 percent in 1981/82, 13.1 percent in 1982/83, and 16.4 percent in 1983/84. The latter is calculated as a residual, including unrecorded expenditure items, change in paycheck arrears, and check float, along with statistical discrepancies.

3/ Change in deferred payments, including payment of arrears.

4/ Change in fonds réservés.

5/ Includes arrears of central government and decentralized agencies (e.g., CPSP, SONAR).

6/ Change in accounts payable.

7/ Domestic arrears only.

of the years shown in Table 1. For 11 of the 14 countries, the change in arrears has reached over 20 percent of total financing in at least one year; in four countries it has been over 50 percent in at least one year, and in 1981 the increase in recorded arrears in Turkey appears to have been equivalent to the overall government financing requirement.

Aside from its magnitude, the change in arrears has displayed a much greater degree of volatility over time than other fiscal aggregates. For example, consider the impact of such fluctuations in arrears on small economies such as Niger, which increased arrears in 1981/82 by 12 percent of total expenditure and reduced arrears by almost 13 percent in 1983/84; or Sierra Leone, which increased arrears in 1981/82 by almost 19 percent of expenditures and in the following fiscal year reduced them by 9 percent of expenditure. In part, these fluctuations in arrears have undoubtedly been encouraged by the need to meet credit ceilings imposed by the existence of Fund programs, but in part this volatility is also likely to reflect changes in recording procedures or changes in valuation (particularly if arrears are on external obligations). Unfortunately, the variability in the series is also likely to reflect the fact that changes in arrears often function as a "balancing item" in the fiscal accounts. Whatever the reason, the size of the change in arrears, coupled with its volatility, implies both considerable adjustment on the part of the private sector in accommodating such changes. It also suggests that for many program countries, the elimination of arrears has posed considerable obstacles to fiscal adjustment.

III. Identification Problems

In principle, the concept of arrears appears uncomplicated, equalling the total outstanding obligations due for payment that the government has failed to discharge within a 'reasonable' time period. The only obvious discretionary issue is the definition of when the time-lag between the creation of a payment obligation and its discharge becomes sufficiently abnormal such as to imply the existence of an 'arrear', or in the case of a prolonged delay, a default. In reality, the identification and measurement of arrears is rarely straightforward, being dependent on the institutional arrangements of the country concerned.

There is also a significant difference in the factors which have led to the accumulation of government domestic arrears across countries, particularly as between the majority of Francophone and Anglophone countries. In part, this reflects differences in the monetary arrangements or legal requirements which limit a government's access to central bank credit. This has been complemented by differences in the way in which the French and British accounting systems record government payment obligations and their settlement. For example, in those Francophone countries sharing a common central bank, legal limits are placed on a government's central bank borrowing, with the result that once that limit is reached, arrears become the balancing item between total commitments and other sources of finance. In countries with British institutional arrangements, legal limits on the government's ability

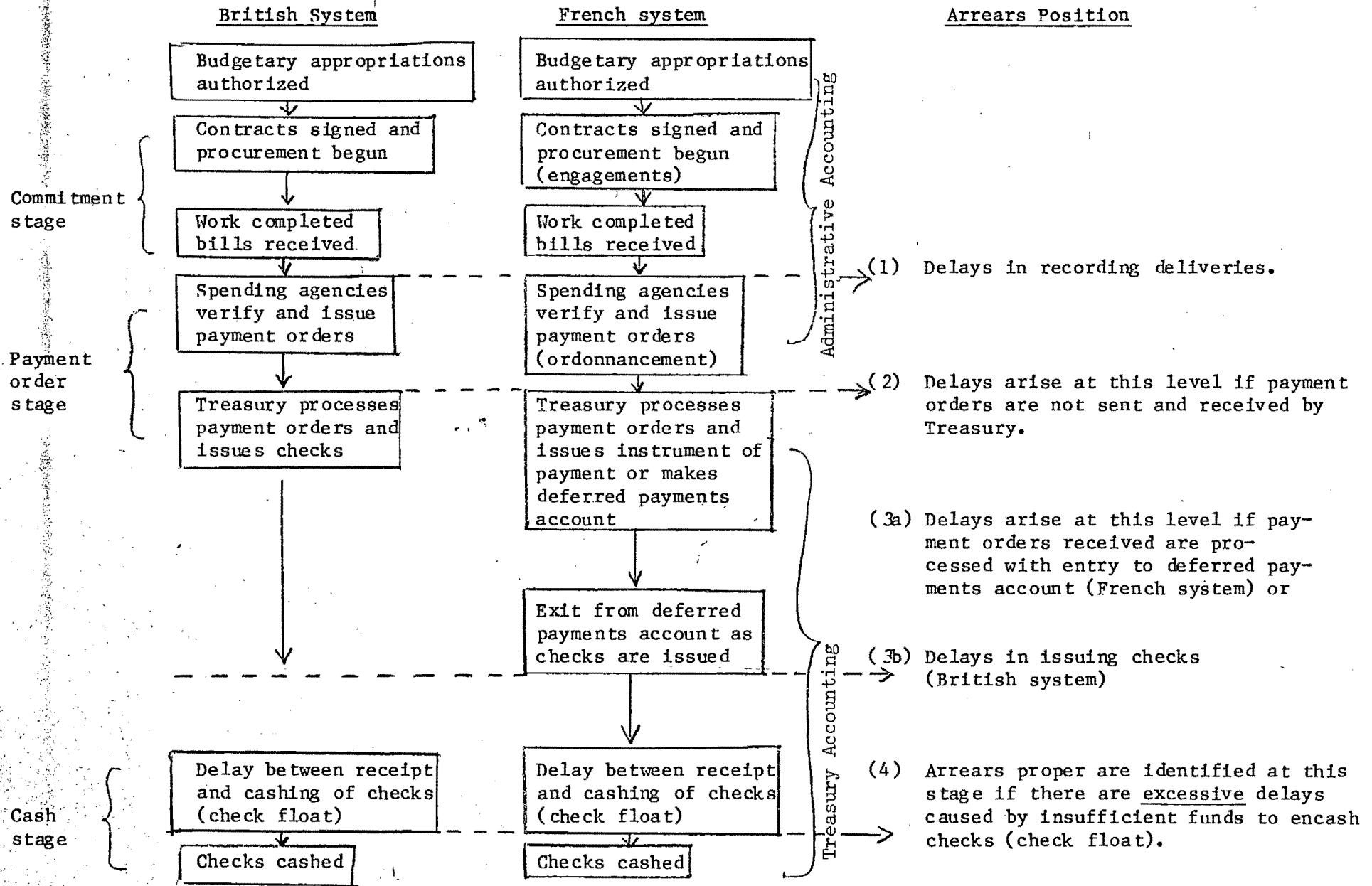
to borrow from the central bank rarely apply and because of this, the government typically has no difficulty in staying current in its domestic obligations. However, domestic arrears have recently become evident in some of these countries, typically in conjunction with Fund programs which place limits on government domestic bank financing (or domestic statutory limits on spending or credit to the public sector). Such limits have made it more tempting for countries to resort to the accumulation of arrears in order to circumvent these limits. 1/

Similarly, differences are evident between the two institutional systems regarding the reasons for the incurrence of foreign arrears. With the monetary arrangements typically prevailing in Anglophone countries, foreign arrears reflect a shortage of foreign exchange which constrains the externalization of government payments to meet foreign currency commitments. On the other hand, since many Francophone countries have access to the French treasury, the problem of externalization of payments is not the binding constraint in meeting their external obligations. Rather, for these countries the problem remains one of obtaining the local funds with which to meet these obligations. As a consequence, in causal terms, domestic and foreign arrears in many Francophone countries have arisen from a common source.

1/ Obviously, effective adjustment under a Fund-supported program requires mutual trust between the Fund and the member country. A point discussed in "Reporting and Other Problems on Performance Criteria in Fund Arrangements--Legal and Policy Issues" (EBS/84/94), and "Misreporting and Noncomplying Purchases Under Fund Arrangements--Guidelines on Remedial Action" (EBS/84/196).

If the reasons for the incurrence of government arrears differ in the French and British institutional systems, the means of identifying and quantifying them also differ. In its simplest form, the spending procedures of the British budget and accounting system involve the following steps. After receiving the authorization to spend, Ministries or spending departments may enter into commitments with suppliers for the purchase of goods and services. The deliveries of these goods and services signify an obligation on the part of the government, which is then liable for payment. Payment orders are usually prepared and issued by the receiving Ministry after certification that delivery has been made. On the basis of these payment orders, checks or warrants are issued by the Treasury or the Ministry payment officers and sent to the suppliers. When these checks are presented at the banks, and the Treasury or Ministry accounts debited, the government can be said to have discharged its payment obligations. Normal delays in the government meeting these obligations obviously arise from inevitable time lags in the government's spending procedures. Typically, delays in final payment are a manifestation of delays at earlier stages in the spending process, viz., in the recording of deliveries, in the issuance of payment orders, the processing and preparation of payment checks, or in the actual issuance and release of checks (see Chart 1). While the concept of arrears in this accounting system is typically held to signify the existence of delays over and above some 'normal' level at the last stage of the payments process, it is important to stress that delays can also originate at any of the earlier stages.

Chart 1. Arrears and Time Lags in the Stages of the Expenditure Process



In an ideal world, with current data available on goods delivered, checks and payment orders issued and checks cashed, it would be comparatively easy to identify deviations from 'normal' lags in the system. However, in some countries following the British budget and accounting system the most current and often the only data available will be checks-issued expenditure data, so that it is only possible to identify the 'normal' check float (i.e., the recorded difference between total checks issued and total checks cashed). In other cases, the only expenditure data available is likely to be either on a commitment (e.g., prior to deliveries) or on a payment order basis (e.g., subsequent to deliveries), giving rise to a discrepancy between the latter totals and the total of checks cashed.

In cases where only commitment data are available, some of this discrepancy should in principle not be classified as arrears, e.g., the amount of commitments for which delivery of services has not occurred. Even the emergence of a significant difference between the issuance of payment orders and the amount of checks cashed--the total of unpaid obligations--overstates the magnitude of arrears, consisting of both the 'normal' check float, and those obligations which the government has not yet discharged. The latter may reflect normal lags in the preparation of payment orders and check issuance, but it may also reflect obligations which the government either cannot discharge (i.e., arrears proper) or refuses to discharge (i.e., in situations where the government disputes a claim).

Thus, in the British accounting system, it is usually quite difficult to isolate out an accurate measure of arrears from the available statistics, which are often inaccurately referred to as the check float (since it may embody any one of the earlier stages between the commitment of an order and the issuance of a check). Some crude rules of thumb are typically employed to identify deviations of the available check float measure from the levels that have normally prevailed in the past. For example, past levels of check float are often related to some other fiscal aggregate, such as total revenues or the sum of total expenditure and check float. Significant deviations are typically imputed as a crude measure of arrears.

The identification of government arrears in countries which have adopted the French budgetary and accounting system encounters different problems. A common feature of the French system is the need to distinguish between two separate stages of the accounting system: the administrative accounting phase (comptabilité administrative) and the Treasury accounting phase (comptabilité du Trésor). While the former covers the initial stages of expenditure implementation (from the point when goods and services are ordered until a payment order is issued), the later encompasses the financial phase (from the arrangement of payment through the discharge of the government's payment obligation). (For a comparison with the British system, see Chart 1.)

In the administrative accounting phase, expenditures are first recorded as commitments (engagements) when a purchase order or contract is signed. Commitments are generally proposed by the spending agency

and usually without the approval of the Ministry of Finance. After the service has been rendered or the goods delivered and the corresponding bill received, the spending agency verifies that the service was actually performed (verification) and establishes the exact amount of the claim (liquidation). Then a payment order is prepared by the spending ministry and sent to the Treasury (ordonnancement). This is the last stage at which expenditures are recorded in the administrative accounting system. Normally, the payment orders are recorded by budgetary items.

The Treasury executes the financial phase of the expenditure process and records this in its accounts. The monthly statement of accounts (balance générale des comptes du Trésor) shows the position of each account and their movements from the beginning of the fiscal year. 1/ After a payment order has been received by the Treasury and acknowledged as valid (visement), and the check is signed and released (mandatement), the expenditure is recorded in the accounts of the Treasury, thus debiting the expenditure account. The counter entry can be made in various accounts, depending upon the manner and the speed with which the government discharges its payment obligations; frequently, a financial account or a third party account (if the payment is to be charged directly to the payee's account with the Treasury) is credited. In many countries an important means of payment is the cash voucher (bon de caisse), used either for expenditure on personnel or goods and services. The cash voucher can be cashed at the Treasury or

1/ These movements are used to adjust the ordonnancement data which are typically the raw material for the processing of fiscal aggregates in the GFS statistics.

at any local branch of the Treasury. The cash vouchers are used not only for general budgetary expenses, but also for extrabudgetary accounts and local governments.

The Treasury may decide to defer payment on payment orders received, which are otherwise perfectly regular and valid. In this case the credit entry is made in the deferred payments ("virements différés," "fonds réservés") account. When payments are actually made, these accounts are debited by the credit of the financial account concerned. A special kind of deferred payments account is the account for expenses to be settled in the following month. This account operates as follows. Suppose a payment order pertains to December but payment is made in January. In December the payment order is debited to expenditure and a counter-credit is made to the account for expenses to be settled in the following month. In January the account for expenses to be settled that month is debited and a financial account credited. After the January accounts are closed, both entries in the account for expenses to be settled will be merged and the account balanced. Meanwhile, however, when considering December final accounts, one finds a credit balance to the account for expenses to be settled next month, which is typically treated as an outstanding payment arrear.

Thus, in the French system, in principle, it is relatively easy to identify government arrears regarding the expenditures that have entered the accounting system of the Treasury. One has only to take the balances of the accounts which record expenditures that are to

be paid. This typically includes the deferred payments accounts (arrières de paiement) and the account that records the outstanding amount of cash vouchers (bons de caisse). In many countries, experience shows that the deferred payments accounts have been frequently used as balancing items between expenditure commitments and available financial resources.

Arrears, as reflected in the outstanding amount of cash vouchers, differ somewhat from other Treasury arrears. The instrument of payment has been issued and it is up to the payee to present these vouchers to the cashier in the Treasury. In this way the Treasury has no real control on the amount of outstanding cash vouchers and cannot ensure the outstanding amount of cash vouchers do not exceed the normal float. However, the situation is different if the Treasury continues issuing cash vouchers but does not accept them if presented to the cashier. Since cash vouchers are not transferable, the holder of the cash voucher has no choice but to wait until the Treasury has sufficient financial resources to discharge its obligation. If the cash voucher were transferable, it could easily become a means of payment and so increase domestic liquidity. Such a situation has in recent years arisen in one African country which in most respects follows the British accounting system, where checks were released in excess of financial resources. Consequently, government checks started to circulate at a discount in the economy as a means of payment.

As with the British system, the identification of the emergence of arrears is complicated by delays in processing incoming bills prior to the issue of payments orders (e.g., recorded expenditure commitments awaiting issue of a payment order). At this stage of the expenditure process, arrears are not reflected in Treasury accounts, but only in the administrative accounting system. They can be measured only with information from spending agencies on the amount of unprocessed bills, a comparatively difficult and time-consuming procedure.

In both systems, the basic issue as to the time interval at which a delayed payment constitutes a true arrear, is further complicated in practice by other features of government payment procedures. For example, the government may enter into commitments with suppliers for the immediate purchase of goods and services or into contracts providing for future delivery. In the latter case these contracts give rise to government liability for payment at some future time, generally set out in the purchase contract. Indeed, in the case of capital projects there may be significant lags between the delivery of goods or completion of work and when the government's legal obligation to pay becomes operative. In this way changes in the composition of expenditure can distort the definition of a 'normal' delay in payment. In some countries the difficulty has been compounded by domestic contractors offering the government what amounts to suppliers' credits. Furthermore, if difficulties are encountered in identifying when a delay in payment can be regarded as an arrear, there are also problems in defining

the time period when the government's delay in payment has become so protracted as to constitute a default.

Serious identification problems arise for those expenditures which have been committed outside of the regular commitment process and which have not yet been recorded in the administrative accounting system. In some countries arrears of this nature have been reported as expenditures yet to be regularized (depenses en cours de régularisation). They often reflect extrabudgetary expenditures and expenditure overruns, the latter stemming frequently from unrealistic provisions in the budget. Instances of underbudgeting (e.g., electricity, telephone, and water) are sometimes the result of a government's inability to take necessary adjustment measures while constrained by basic accounting principles to make the budget balance by law. Another problem of identification may arise with respect to arrears on debt service. A number of Francophone countries have established amortization funds to manage the servicing of government debt. In this case debt arrears are reflected neither in the Treasury accounts nor in the administrative accounting system, but must be obtained from the accounts of the amortization fund.

To sum up, the identification of arrears is simpler in the French accounting system, reflecting a greater degree of centralization in the processing of expenditure data. Both accounting systems offer indicators of potential and realized changes in arrears that provide diagnostic data on the emergence of arrears without major operational

difficulties, although these differ significantly in coverage. In the French system, expenditures are centrally recorded as soon as delivery is made and the claim is examined and judged appropriate and legal, even though no check has been issued. Hence the French system, when functioning properly, offers a direct, although perhaps incomplete, indicator of the emergence of arrears relatively early in the expenditure process.

The British accounting system, on the other hand, does not offer this intermediate indicator of changes in arrears. A comparison of actual deliveries with payment orders issued typically is likely to be done only in a piecemeal fashion by the spending departments as part of their day-to-day operations. To consolidate such data usually requires a special exercise. ^{1/} Consequently, to estimate the change in arrears under the British system, typically reliance is placed on data generated at a relatively late stage in the expenditure process, on the change in 'checks float', which often is only a small part of arrears. However, it should be noted that though the French system tends to offer a more comprehensive indicator of arrears, this also may only reflect a part of total arrears. In one Francophone country, for example, the recorded stock of arrears at the level of the Treasury dropped by about 50 percent in 1983. However, a subsequent inventory

^{1/} In at least one anglophone country, for monitoring purposes, spending departments were required to report commitments and cash expenditures, which when compiled provided a better coverage of arrears.

of payment arrears showed that the total amount of government arrears had not changed. While payment orders issued awaiting settlement had decreased, delays at an earlier stage of the expenditure process had increased.

IV. Taxonomy of Government Arrears

To identify and address the problem of government arrears, it is useful to develop a taxonomy by which to classify arrears. The following criteria are useful: (1) the economic type of payment to which the arrear relates; (2) the payee to whom the payment is due; and (3) the residence of the government's creditor.

1. Economic type of payment

An arrear may develop with respect to a government's expenditure on goods and services, its transfer payments, and its interest and amortization payments. A government expenditure normally comprises two corresponding flows between the government and the rest of the economy: a physical flow of goods and services to the government and a flow of money to the rest of the economy. When the government excessively delays its payment, and thus the flow of money to the rest of the economy, an expenditure arrear is created. In this way, while the government initiates an income-creating flow of goods and services from the rest of the economy to the government, there is no reverse injection of money into the economy. Government transfer and interest payments do not involve a flow of goods and services to the government, but like

expenditures on goods and services, add to the income of their recipients. If transfers or interest payments are postponed, the income of the beneficiaries increases only on an accrual basis, not on a cash basis. Amortization payments do not affect the income of the rest of the economy, but result in the substitution of money for a claim on government. If amortization payments are delayed, this liquidation does not occur and instead, a formal claim on government is replaced by a more uncertain one, reflecting the arrear. Thus an expenditure arrear, that is, an arrear on the purchase of goods and services or an arrear on transfer and interest payments, reflects an income creating process (at least on an accrual basis) as well as an increase in claims on government in the financial portfolio of the rest of the economy. On the other hand, it can be argued that an arrear in amortization payments only involves a liquidity effect, leading to the substitution of a formal claim on government by a more uncertain one in the portfolio of the rest of the economy.

This difference between amortization and expenditure arrears has led to additional differences in statistical presentation, as discussed in Section V below. It is also useful to distinguish between amortization arrears due to banks and nonbank institutions. Unpaid amortization payments on domestic government debt held by domestic banks are typically counted automatically as part of the banks' claims on the public sector (i.e., automatically refinanced) and therefore usually appear in the monetary data as net claims on the public sector. Including them as arrears in the presentation of the fiscal accounts would result in

double counting the same source of domestic financing, and thus arrears to banks should not be shown in the presentation of the fiscal accounts, except as a memorandum item.

As for expenditure arrears, arrears on interest payments, particularly on those due to foreign creditors, have recently become prominent, giving rise to debt rescheduling arrangements by the Paris Club. Such arrangements have helped limit the extent of foreign interest arrears. Arrears on wages are seldom incurred, mainly for political reasons. In one African country, however, the government deliberately accumulated paycheck arrears over a given period; in effect, the government preferred to reduce the wage bill through a progressive stretching-out of the period between wage payments rather than by an explicit reduction in wage rates. Arrears on investment expenditure are typically related to the domestically financed component of expenditure, and may reflect an overambitious investment program, poor expenditure control, an unexpected shortfall in foreign financing, or the inability of the central government to reimburse public enterprises for investments undertaken on its behalf.

2. Arrears by payee

The government may create arrears to the private sector or to other units within the public sector. Experience shows that if governments respond to spending pressures by accumulating arrears, they begin doing so vis-à-vis other public sector entities; for example, by not paying utility bills. It has been argued that as public

enterprises are owned by the government, arrears vis-à-vis public enterprises do not affect the overall financial position of the government. However, such a mechanical accounting procedure masks the very real problem of a lack of financial discipline. Similarly, if one takes a broader view encompassing the entire public sector, as is often done in Fund programs, it could also be argued such arrears are in any case consolidated. Again, such a consolidation would merely hide an important policy problem. Moreover, insofar as the public enterprise has minority private shareholders, or is making losses financed outside government, or as a result of government arrears is forced to build up arrears with its suppliers, the impact on the rest of the economy may be significant. Arrears to the private sector have often induced the private sector to hold back tax payments, creating tax arrears. This has sometimes resulted in a log-jam of interlocking arrears throughout the economy.

3. Domestic versus external claims

Another important distinction is that between domestic and external arrears. The criterion for this classification is whether the creditor resides within the country or abroad. Often this distinction coincides with whether the claim on the government is denominated in local or foreign currency. As a result, the existence of domestic arrears usually reflects a corresponding shortage of budgetary resources, while external arrears reflect a shortage of foreign exchange, constraining the externalization of government payments to

meet foreign commitments (see Chart 2). Generally, such imbalances are likely to occur simultaneously. Therefore, external arrears typically coincide with balance of payments difficulties while domestic arrears arise from a budgetary imbalance.

This distinction is lessened if the domestic currency is externally convertible; in such cases, the emergence of domestic and external arrears generally reflects a budgetary problem. In the case of countries belonging to a currency union such as the West African Currency Union (CFA franc area), where domestic currencies are convertible and where union member countries enjoy easy access to borrowing from the French Treasury, the distinction between domestic and external arrears is thus lessened. 1/

In countries where government revenue is sufficient to cover expenditure or where the central bank is authorized to extend credit to the government as needed, but where there is a shortage of foreign exchange, the externalization of payments rather than the domestic counterpart poses a problem. In such countries blocked accounts for the domestic counterpart of external obligations have been found useful. (For a discussion of the use of these accounts, see Section VI.)

1/ For this reason, the Paris Club assesses the debt relief requirements of these countries on the basis of budgetary data, not on the basis of balance of payments data.

V. Presentational Problems

To provide an accurate analysis of the impact of government operations on an economy, it is necessary to evaluate the magnitude, sources, and financing of government deficits. In the Fund's Manual on Government Finance Statistics, the deficit is defined as:

$$\text{Fiscal deficit} = (\text{Revenue} + \text{Grants}) - (\text{Expenditure on Goods and Services} + \text{Lending Minus Repayments})$$

If this measure of the deficit is to be fully compatible with the financing data derived from the monetary survey, it should be measured on a cash rather than an accrual basis. 1/ Arrears should not be treated explicitly, but should be shown as a memorandum item since by definition, they reflect outlays not yet consummated on a cash basis. 2/

However, while such a definition captures the monetary impact of the budget, it does not--in the presence of an accumulation of arrears--fully capture its income-creating impact. 3/ Expenditure measured in cash terms will exclude any build-up of arrears, even though the latter may have set in motion corresponding income-creating effects. Government purchases of goods or services will most likely

1/ In BOP statistics, on the other hand, data are generally shown on an accrual basis with arrears shown as an adjustment in the current account with an offsetting entry in the capital account, with no change in the overall balance of payments.

2/ The exception is the adjustment of commitments expenditure data to a cash basis, typically required in francophone countries. See A Manual on Government Finance Statistics, pp. 91-92.

3/ Conversely, the cash deficit overstates the income-creating impact of government operations when arrears are reduced.

Chart 2. External and Domestic Arrears

	Convertible Currency	Nonconvertible Currency
Budgetary Resources Sufficient	No Arrears Problem	Only External Arrears Problems Blocked Account an Issue
Budgetary Resources Insufficient	External and Domestic Arrears Problem	External and Domestic Arrears Problem

have an impact on incomes and on domestic credit, even when payment is not made, i.e., arrears are accumulated as the government effectively finances its deficit through an involuntary expansion of suppliers' credits or forced credits from employees, creditors or other agents in the economy. In terms of policy, the credit expansion should be correctly attributed to the originating sector, specifically, the government.

Recognizing the importance of such distortions when formulating policy, two alternative presentations of the fiscal position have been advocated to overcome the drawbacks of a purely cash basis presentation in the presence of arrears. First, expenditures have been shown on a commitments basis, with the difference between total cash financing and the resulting deficit shown as a financing item. As indicated in Section III, the difference, in considerable part, reflects a combination of check float and arrears. Unfortunately this has meant that total financing, by including a noncash component, is not immediately reconcilable with monetary statistics. The second approach is to show the overall deficit on a commitments basis, with separate lines for the net change in expenditure arrears-cum-float and a corrected overall deficit on a cash basis, i.e.,

- a. total revenue and grants (cash basis),
- b. total expenditure (commitment basis), 1/

1/ Preferably on a payment orders issued basis.

- c. (a - b) overall deficit (commitments basis),
- d. net change in expenditure arrears-cum-float
- e. (c + d) overall deficit (cash basis), and
- f. financing (cash basis).

This approach encounters a number of practical presentational problems:

a. Combining estimates with actuals

The accuracy and utility of the above presentation depends critically on the ability to identify and quantify the change in arrears, and brings to bear some of the issues raised in Section III. In many cases all that is available, particularly in the British system of accounting, is the change in the so-called 'check float' measure. The question then arises whether this change could be considered 'normal', in which case it should be excluded from the presentation of the fiscal accounts, or whether it indicates a significant change in arrears. ^{1/} This question was addressed in Section III, where rules of thumb, necessarily of an approximate nature, were suggested for judging whether a change in check float should be considered 'normal'. In other cases specific arrears

^{1/} It is possible that in any given period, an unusual change in the check float measure may reflect a structural change in the true level of the cash float, rather than a significant increase in arrears.

(e.g., on external debt service payments) can be identified, but the total change in arrears may still be difficult to quantify. In these cases an expenditure arrears line is shown as 'identified expenditure arrears', and when the arrears on amortization payments can also be identified, these can be shown as a memorandum item with total identified arrears divided into their expenditure and amortization components.

b. Treatment of arrears on amortization

The suggested fiscal presentation does not explicitly treat government arrears on amortization payments, because all financing items are shown on a cash basis. As a consequence, the accumulation and the reduction of amortization arrears are shown asymmetrically in the suggested fiscal presentation. Since all financing items are on a cash basis, there is no way to represent the accumulation of amortization arrears, except as a memorandum item. When the government discharges its overdue obligations, however, the payment is shown as a financing item.

This can be illustrated by the following example. Let us assume that in period t the government spends 10 units on goods and services but does not pay for them and a debt amortization payment of 15 also falls due, which the government is unable to honor. In period $t + 1$, the government receives 25 units in revenue and discharges all its overdue obligations. The fiscal presentation should reflect these financial obligations as follows:

Table 2. Summary of Government Operations

(In domestic currency units)

	Period t	Period t+1
Revenue	0	+25
Expenditure	10	0
Overall balance (commitment basis)	-10	+25
Change in expenditure arrears (- decrease)	+10	-10
Cash balance	0	+15
Financing	0	-15
Repayment of amortization arrears	0	-15
Other	0	0
<u>Memorandum item:</u>		
Change in amortization arrears	+15	-15

This example shows that while an accumulation of expenditure arrears is reflected in the fiscal presentation in the form of a higher overall balance on a commitment basis, the incurring of amortization arrears is not immediately obvious from the fiscal table. However, because cash amortization payments equal amortization payments due plus the change in amortization arrears, this presentation problem could be mitigated by disaggregating the line for repayments and by showing two sublines for repayments due and for change in amortization arrears as follows:

Table 3. Summary of Financing Operations

(In domestic currency units)

	Period t	Period t+1
Financing	0	-15
Repayments (cash)	0	-15
Repayments (due)	(-15)	(0)
Change in amortization arrears (reduction -)	(+15)	(-15)
Other	0	0

c. Changes in commitments during the financial year

Because arrears are defined as the difference between the government's obligations due and its discharge of these obligations in a timely fashion, problems are encountered in presenting the change of arrears when commitments change during the fiscal year. Such changes may arise from exchange rate revaluations and debt rescheduling agreements. In the latter case, it is important to quantify the additional financing to the budget arising from debt rescheduling and present such financing as a memorandum item. The difference between total commitments after debt rescheduling and discharged rescheduled commitments is the change in arrears shown in the relevant lines of the fiscal table.

An example illustrating some of these presentational problems is the case of the fiscal outturn for a fictitious country, Ruritania (though based on an actual country example). During the fiscal year

the Government benefited from debt rescheduling which lowered its debt servicing commitments. Despite this, within the fiscal year, it also accumulated arrears both with respect to rescheduled foreign interest and amortization payments. The situation is described in the following table:

	<u>Debt Service Commitments</u>		Actual Debt Service Payments	Increase in Arrears
	Before rescheduling	After rescheduling		
	<u>(In millions of dollars)</u>			
Interest	140	72	32	40
Principal	253	127	68	59

In this case arrears on interest payments are shown as the difference between the deficits on a commitment and cash basis, and arrears on amortization payments as a memorandum item. It is also helpful to show the change in commitments over the year and this is accomplished by showing the exceptional financing obtained as a result of debt rescheduling as a memorandum item. The suggested fiscal presentation would be as follows:

Table 4. Rouritania: Provisional Outturn

	<u>Millions of dollars</u>
Total revenue and grants	1,170
Total expenditure and net lending	1,556
Overall deficit (commitments basis)	-386
Change in arrears on external interest (increase +)	40
Overall deficit (cash basis)	-346
<u>Memorandum items:</u>	
Change in arrears on foreign amortization (increase +)	59
Estimated reduction in debt services payments as a result of debt rescheduling	194
Of which: Interest	(68)
Amortization	(126)

VI. Economic Effects of Government Arrears

The emergence of government arrears is likely to have ramifications on the allocation and distribution of resources within the economy, both through its effects on factor prices and incomes and through its macroeconomic effects. The most obvious allocational effect, in the short run, is that arrears constitute an alternative form of financing of additional government expenditure. If forced taxation through the printing of money is not feasible, the government's share in total output is limited by the amount the rest of the economy is prepared to release to the government by paying taxes or by extending credit to the government. The build-up of arrears increases the government's absorption of resources above this level. This initial effect, however,

may be offset by the rest of the economy limiting resources transferred to government by holding back on tax payments and other fees and charges.

The development of a chronic pattern of arrears may also influence the costs and prices in the economy. When arrears first emerge as a means of government financing of purchases, the effective interest cost of financing arrears is wholly borne by the suppliers of goods and services (be they producers, importers, or wage earners). Over time, and in the face of further likely arrears by the government, those economic agents providing goods and services to the government may begin to adjust their pricing and production behavior to take account of such payment delays. Vendors dealing with the government may begin to charge higher prices to make up for refinancing costs, a risk premium, and bribes to speed up the payment process. Thus the government may have to pay prices above the market price and, with limited budgetary outlays, be forced to reduce the quantities of goods and services purchased.

The additional premium on prices is likely to be determined by the vendors' expectations about the length of the payment delay, the prevailing interest rate, the risk that the government will default, and the amount of bribe necessary to speed up the payment process. Similarly, there is also a possibility creditors will bid up the interest rate charged on loans to the government if they anticipate that the government will not pay back these loans as scheduled.

The implicit interest costs of arrears are independent of whether or not providers of goods and services bid up prices to account for the delays in payment. The degree to which prices are increased only determines the distribution of the financial burden of the payment delay--the government, by paying increased prices (and ultimately the consumers of its services through reduced services or higher taxes or fees), or the vendors through a squeeze in their profit margins. To the extent that arrears are reflected in higher prices on those expenditure items on which arrears are frequently incurred, it is likely that existing budget statistics provide a biased picture on the true weight of interest costs in the budget, not taking account of the implicit interest costs in the category of expenditure on goods and services.

When examining the macroeconomic effects of government arrears, it is necessary to evaluate how government arrears are created and how the payee reacts to payment delays. For example, the change in aggregate demand brought about by the creation of arrears in wage payments to government employees will depend largely upon their perception of the postponement of wage payments and their underlying consumption behavior. 1/ If, for example, the spending decisions of

1/ In cases where the level of government wages is significantly higher than the wage level in the rest of the economy, such a cut may be desirable both on allocational and distributional grounds. Conversely, where government wages are relatively low, wage arrears may impair the government's productivity, have adverse distributional effects, and provide incentives for corruption as well as for the acceptance of outside jobs.

government employees are determined by their actual cash income, and if the government stretches out the period between paydays so that the civil servants receive only 11 monthly salaries in a 12-month period, then their private consumption will drop by $1/12$. However, if their underlying consumption behavior is more accurately described by a permanent income model of consumption behavior, and if government employees regard delays in salary payment as only transitory, civil servants may perceive only the interest foregone on the deferred payment as a cut in permanent income. Their consumption outlays would then drop only marginally, and the temporary cash shortage would be made up by dissaving. If the civil servants, however, do not have confidence in being able to recover the loss in cash income incurred by the payment delay, the drop in their permanent income will be considerably more than just the foregone interest, and private consumption will fall accordingly.

A similar analysis can be applied to other government payments to private households. Delays in transfer payments to private households and in interest payments on government bonds held by the private nonbank sector will tend to reduce private consumption. The fall in consumption will be determined by the relevant consumption function and the perception of the private household as to whether the payment delay represents a transitory or permanent change in government policies.

In its normal purchases of goods and services from vendors, the government sets into motion an income-creating process that increases

aggregate demand. The effects of the government's incurring arrears in payments will depend upon the way vendors initially finance the production of the goods and services to be supplied to the government. If this financing takes the form of borrowing from the banking system, the impact will be no different than if the government had made the payment on time with proceeds borrowed from the commercial banks. Thus the overall effect on aggregate demand will be very similar to that arising from bank-financed government expenditures. Alternatively, vendors might perceive the incurrence of government arrears as only a temporary phenomenon and thus reduce their cash balances below the level warranted by the prevailing interest rates and their volume of transactions. In this case, the increase in government expenditure would be financed by a higher velocity and aggregate demand might increase. A similar strong effect on demand may be expected if vendors satisfy their financing needs by external short term indebtedness. In some countries, companies have adjusted to the government's inability to meet its obligations by creating arrears to the foreign parent company. In this case, the government has indirectly financed its expenditure by an inflow of foreign short-term capital, with a concurrent improvement in the overall balance of payments. 1/

Finally, it has been observed that companies frequently adjust to the emergence of government arrears by incurring arrears on their tax

1/ Of course, this assumes there are no secondary repercussions when the capital inflow may be matched by an increase in the current account deficit, leaving the overall balance of payments unchanged.

liabilities. Insofar as the vendors not paid by the government in turn retain funds equivalent to the taxes owed to the government, the government in practice is financing its expenditure by foregoing tax revenue, such that the macroeconomic effects are similar to any other tax-financed expenditure, though the timing may be different.

Two additional aspects are worth mentioning. First, if the creation of arrears takes place at a very late stage of the expenditure process, by increasing the stock of outstanding checks beyond the normal check float, and beyond the government's short-term capacity to honor them, then significant monetary effects can be expected. Because government checks are normally highly liquid, money creation takes place and, if the demand for money does not grow at the same pace, eventually this will create pressure on prices and on the balance of payments. ^{1/} Secondly, the accumulation of government arrears may have a serious impact on the confidence of private enterprises and households in the soundness of government financial operations. Private consumers and investors might anticipate increases in the nominal tax rate, inflation, or more generally, a deterioration in the financial situation of the country over the medium term. As a consequence, the expectation will be that permanent incomes and profits will drop, reducing current consumption and investment expenditure.

^{1/} This is dependent on the private sector assumption that the government will ultimately discharge its outstanding obligations.

The macroeconomic effects of arrears on amortization payments are likely to be less than those arising from expenditure arrears, since the former does not set in motion an income-generating flow of goods and services from the rest of the economy to the government, or engender any expectation of accrued income. To assess the effects of amortization arrears, one must evaluate the response of creditors. If the government fails to make a domestic amortization payment on time, the only immediate effect will be a substitution of a formal claim on government by another one, with the total amount of claims of the private sector on government remaining unchanged. This also assumes that government will continue to pay interest on the loan, and that the portfolio owner believes that the government will finally repay the loan. Typically, creditors might try to raise the interest rate somewhat in order to compensate for the higher risk now associated with this part of their portfolio.

If on the other hand, the government stops paying interest and so increases the probability of default, a domestic amortization arrear will lead to decreasing private sector wealth (assuming that the so-called Ricardian equivalence does not hold and that, therefore, government loans are regarded as net wealth by the private sector). ^{1/} Of course, when wealth is an argument in the

^{1/} Under Ricardian conditions, the future taxes implied by government debts are fully perceived by the private sector and completely offset the private sector's claims on the government (see Schiller (FAD (1984))).

consumption function, the creation of domestic arrears on amortization payments will tend to reduce consumption and imports.

Important balance of payments consequences can be expected from the creation of amortization arrears to external creditors, but this is only likely to be felt in the medium-term. In the period when the arrear is created, the capital account goes into deficit but this capital outflow is financed by the creation of arrears, which is shown as exceptional financing, leaving the overall balance of payments unaffected. In the medium-term, however, the government's credit rating could be damaged and the inflow of official capital could very likely dry up.

Do government arrears have an impact on the rate of inflation? At first glance, it appears rather unlikely, because typically no money creation takes place at the time government begins to incur arrears. However, there may exist indirect links between the buildup of arrears and the rate of inflation. First, as described above, suppliers are likely to react to the incurrence of government arrears by bidding up the prices at which they are prepared to sell goods and services to the government. In more general terms, in an environment characterized by financial instability, as reflected by the government's inability to make payments on time, economic agents will include high-risk premiums in the calculation of the price at which they are prepared to render goods or services.

Secondly, if the provider of goods and services bridges the delay in payments by borrowing from the banks, this may add pressure to the credit market, and as in the case of additional government borrowing, push up interest rates. If this effect induces the Central Bank to relax monetary policy or attracts capital inflow, the outcome would also be pressure on prices. Thirdly, if arrears are accumulated against public enterprises, as is often the case, the financial position of the public enterprise sector may worsen. If this results in higher credit from the Central Bank, arrears will end up creating inflationary and balance of payments pressures.

VII. Arrears and Fiscal Adjustment in Fund Adjustment Programs

The importance of arrears in any macroeconomic analysis of the impact of government should be evident from the discussion in the previous section. To sum up, at first glance it would appear that any delay in payment, as a form of compulsory financing of its expenditures, has significant benefits for the government. It is as if suppliers had bought government bonds at zero interest rate for the period until payment is made. However, the persistent use of such compulsory financing should be recognized as involving distinct drawbacks for the government as suppliers react by bidding up the prices at which they will provide it with goods and services. As a consequence the price government has to pay is inflated by the supplier's risk premium or implicit interest rate, increasing

the size of the government's cash deficit; and the general price level may well be raised. Any inflationary impact on the rest of the economy is likely to be exacerbated by suppliers having to incur increased credit to bridge the delay in payments. In this way it could be argued that the effect on the rest of the economy may differ little whether the government has or has not actually paid a supplier, since the latter in all probability had to obtain credit and has definitely used resources to provide goods and services to the government whether or not the government has discharged its formal obligations to him. However, from the perspective of macro-economic policy, it is important to correctly attribute any monetary expansion to the initiating sector: in this case the government rather than the supplier should be recognized as initiating the expansion in credit. Similarly, from the financial programming viewpoint, the build-up of arrears, by disguising the level of the government's use of resources, lowers the recorded deficit and hence also the recorded credit to government.

By concentrating on the net effect of cash flows in the presence of a government accumulating arrears, the recorded deficit can remain constant while in fact the level of government spending is increasing. This distortion has been recognized when formulating Fund programs, where it has been judged important to capture not only the monetary effects of budgetary changes, but also their income-creating or Keynesian impact. ^{1/} The latter, which focuses on the impact

^{1/} See V. Tanzi and M. Blejer, "Fiscal Deficits and Balance of Payments Disequilibrium in IMF Adjustment Programs", DM/83/44, 6/14/83.

of fiscal policy on the gap between domestic income and expenditures, would place emphasis on an accrual rather than a cash definition of the deficit and would concentrate on the change in government commitments, regardless of whether they were discharged in cash.

Operationally, in the treatment of arrears a distinction is usually made between external and domestic payments arrears. This arises in part because while the government discharges its debt service obligations in domestic currency, the final payment of external obligations has to be undertaken by the central bank as part of its management of foreign exchange. It is this feature, related to constraints on discharging obligations, that has led to different treatment in Fund programs. Thus, while a government can in principle usually discharge its obligations in domestic currency, even though this means borrowing from the central bank, foreign exchange may not be available to discharge the central bank's corresponding external obligations. As suggested in Section III, an exception to this general rule arises in some Francophone countries which operate a common central bank and have financing constraints placed upon them (see Chart 2). In these countries domestic arrears have been a recurring problem. While in Fund programs the general aim has been to avoid the distortions caused by arrears, whether they be domestic or external, the means of accomplishing this has, in general, differed according to whether the arrears are principally domestic or external.

Domestic arrears

In the case of domestic arrears a more direct approach has generally been advocated, with a reduction in arrears programmed as a performance criterion. This approach was in response to some early programs where the change in "checks float," although only partially capturing changes in arrears, was excluded from domestic financing when calculating the ceiling on central government borrowing. Without a separate ceiling or a commitment to reduce these arrears, this item consequently became a buffer "cushioning" the restrictiveness of government credit ceilings and correspondingly tightening the credit ceiling in the rest of the economy. For example, if revenues did not rise as programmed, this could be offset by a smaller domestic arrears reduction.

Unfortunately, considerable operational difficulties and dangers have to be faced in this direct approach to the problem of arrears. To be feasible, programming limits on arrears as a performance criterion requires the existence of certain preconditions. In particular, there must be: (1) a clear definition of what constitutes an arrear, (2) a complete inventory of arrears based on this definition, and (3) a timely method of monitoring changes in this inventory. In practice, all three preconditions are difficult to meet.

In identifying domestic arrears, difficulties usually arise in dealing with overdue obligations which have arisen from dubious authorizations, and are yet to be regularized, or in isolating that part of the check float than can truly be considered as constituting arrears. Compiling a comprehensive inventory of arrears has in

practice proved difficult and time consuming, especially when they have arisen from Ministries undertaking unauthorized expenditures. Thus in many cases the experience has been that originally agreed program limits on domestic arrears have been embarrassed by newly discovered arrears in the course of the program period. For example, a new methodology of quantifying arrears in a Francophone country suggested that public sector payment arrears in particular years had not been reduced by the amounts estimated by a previous methodology, but had in fact increased. Similarly, the performance criteria regarding the ceilings in the level of domestic arrears had to be modified during the stand-by program with another Francophone country when a new survey revealed a much higher initial level of outstanding arrears.

The data problems in some program countries have been so severe that even when an arrears problem is recognized, it has not been possible to include program commitments to prevent the incurrance of new payment arrears or the reduction of outstanding arrears. For example, without an inventory of past domestic arrears, it was impossible to establish a monitoring system for reducing these arrears in one country. Similarly, in a recent program with another country, and despite recognition of the arrears problem, intractable data problems precluded the quantification of their magnitude, adjustment for them in the presentation of the fiscal accounts, and inclusion of a performance criterion on arrears.

Even if this basic data problem could be overcome, the introduction of performance criteria on arrears seems doubtful in the absence of an effective within-year expenditure or arrears monitoring system. Such a system is likely to take time to institute and may involve unacceptable reporting lags. Such a system would of necessity have to come to terms with the particular budgetary procedures of the country. To get a realistic picture of the movement in government arrears, it has been found necessary to trace the changing stock of commitments, payment orders, checks issued and checks cashed, and to have a reporting system at the different stages of the expenditure process.

Even when these preconditions are met, introduction of a performance criterion on arrears would require a clear decision on what would constitute a legitimate reduction in them. For example, the government may attempt to reduce arrears by issuing government paper rather than by discharging its commitments in cash. In such cases it seems necessary to ensure that the maturity of the bonds, the level of their interest rates, and the degree of their negotiability would not differ from that of other financial instruments. At the same time it should be recognized that the conversion of arrears into government debt would be equivalent to any other rescheduling of debt in terms of its potential expansionary impact and would necessitate an equivalent reduction to any ceiling on credit to government.

Another factor that arises in many countries is the problem of interlocking arrears. In these cases, while the government has undischarged payment obligations to a domestic supplier or enterprise, that enterprise in turn has unfulfilled tax liabilities to the government. The size of these mutual commitments is often in dispute, resulting in a bargaining situation with each side trying to gain advantage by writing off the larger outstanding obligation. Obviously from a financial programming viewpoint, the criterion on the reduction of arrears would be affected by whether the government's undischarged commitments were treated gross or net of tax obligations due to it.

In adopting a particular approach to monitoring performance criteria with respect to arrears, experience also suggests it is important to take into account the particular institutional characteristics of a country. Two particular institutional scenarios seem to be worth distinguishing. In the first, the Treasury is not in full control of the spending process, so that powerful spending departments are able to make unauthorized commitments. In the second case, the Treasury does exert control over the spending process but does not honor its commitments. In the former case the solution to the arrears problem may be particularly difficult to resolve, being symptomatic of a more general problem of expenditure control. In cases where the Treasury's accounting

system is sound, arrears are more symptomatic of a lack of political will to restrain public spending. Moreover, when faced with Fund performance criteria, the authorities, by having full control over the accounting system, are in a better position to hide 'arrears' at an earlier stage of the expenditure process (e.g., before they would normally emerge) where they are less amenable to outside monitoring.

Overall, experience with past programs has led to the argument that the institution of performance criteria on arrears may be undesirable, since it tends to put pressure on authorities to subvert established accounting procedures, which once damaged, may be hard to reinstate and with a consequent loss of policy information. This subversion has typically been accomplished by finding different ways to delay the recording of payment obligations or payments made. For example, a stand-by arrangement with one francophone country included changes in the stock of a specific arrears account as an additional performance criterion. Unfortunately, a detailed inventory of payment arrears established subsequently showed that the introduction of this performance criterion had only changed the structure of domestic arrears. Payment orders issued and awaiting settlement had indeed declined, while delays at an earlier stage of the expenditure process had increased.

It may also be possible to slow up the writing of checks, or when they have been written, to slow up their release. Even when

checks are presented to the banks, there may be delays encouraged in discharging payment or in recording the debits from government accounts. A program in an Anglophone country, in particular, demonstrated how the scope for delaying the recording of payments presents problems when monitoring government credit ceilings. For example, it was possible for the government to issue a check for payment of its obligations, with the check being debited several days after the performance criterion test date. In several periods when performance criteria were to be observed, cash expenditure flows were clearly altered with the objective of attempting to comply with the net credit to government ceilings. In this way, a change in arrears was clearly a direct consequence of Fund program credit ceilings.

Furthermore, one might wonder whether the methods which were instituted to control expenditures in the stand-by arrangement with this country may not have increased the arrears problem. For example, under the expenditure control system implemented, separate accounts for authorized capital expenditure and recurrent expenditure were established for each Ministry at the Central Bank, which was instructed by the Ministry of Finance not to permit overdrafts in any Ministry's account. To meet these monthly cash ceilings, spending ministries tended to delay issuing checks.

Recognizing that the use of performance criteria might endanger the disciplines of the accounting system, some programs have adopted

a broader approach to the control and eventual elimination of arrears. In these programs overall expenditure or major expenditure components are subject to indicative expenditure targets, adherence to which would obviate the need to build up arrears (or allow for their progressive reduction and eventual elimination in cases where there are arrears outstanding at the beginning of the program). Nonobservance of these expenditure targets, which may be monitored on a monthly or quarterly basis, normally trigger consultations with the Management of the Fund. Particularly in cases where arrears have been incurred in the past, and subject to the availability of information, these expenditure targets have been complemented by performance criteria on arrears. When information has been insufficient for the setting of such performance criteria, and arrears have not been a major problem in the past, the Letter of Intent has often included as a general statement the intention of the authorities not to incur such arrears in the program period.

External arrears

On the whole, external arrears, especially those with respect to debt servicing, have been more easily identified, inventoried and monitored. A less direct approach has been applied in Fund programs to limit the problem of external arrears. This has involved separating the domestic counterpart of foreign obligations from their actual externalization in order to prevent the accumulation of arrears on the domestic counterpart of external payments. In

situations of foreign exchange shortages, a special blocked account for the domestic counterpart of scheduled official external payments has been found useful in some countries. Typically, programmed transfers to these accounts have been used as a performance criterion in Fund programs. The magnitude of such transfers has been calculated so as to ensure that adequate provision is made from domestic budgetary resources for the domestic counterpart of such obligations, regardless of the availability of foreign exchange to complete the externalization of these payments. In this way some attempt has been made to limit the possibility of the government avoiding the restrictiveness of credit ceilings by not meeting external debt service commitments.

The use of blocked accounts has now been employed in a number of program countries. ^{1/} Their use has been predicated on the existence of a fairly reliable schedule of debt service commitments. Although a recent Fund program did contain a commitment to set up a blocked account for the domestic counterpart of official external debt servicing payments, the precondition of a reliable schedule of commitments did not exist. Inadequate data regarding the extent of arrears, and the amount of domestic counterpart deposits already held by the central bank, delayed implementation. The experience with blocked accounts in other countries has been mixed. In some

^{1/} For a more detailed discussion of this topic, see H. Bierman, "A Note on the Domestic Counterpart to External Arrears and External Debt Service" (FAD, 1985, unpublished).

cases, projected levels of debt relief from rescheduling were overestimated and in other cases, further external commitments became known during the program period. In at least one case, counterpart deposits of the blocked account were not sterilized, but used to circumvent government credit ceilings.

VIII. Concluding Remarks

This paper has reviewed the nature of the problems and various consequences associated with the accumulation of government arrears. It has been argued that to neglect any arrears accumulation and concentrate on the government's deficit on a cash basis alone would distort the deficit as an indicator of fiscal stance. Although much depends on the responses of different economic agents in the economy to government payment delays, it has been argued that any short-term advantage gained by the government is likely to be more than compensated by undesirable longer-term effects both on itself and the economy at large. Accumulation of unpaid government obligations, tends to increase the prices the government is forced to pay for goods and services, encourages reciprocal private sector arrears on tax liabilities, stimulates excess monetary creation putting pressure on prices and the balance of payments, and ultimately adversely affects confidence in the financial soundness of government.

As an obvious starting point to examining possible solutions to the problem, this paper has discussed how government payment arrears have arisen and how they may be detected. Throughout this

discussion, the importance of institutional arrangements has been highlighted, particularly the differences in identifying and quantifying arrears in those countries operating on a British as opposed to a French type of budget and accounting system. However, despite these differences, it was concluded that, in principle, all accounting systems are capable of providing some rough operational indicators of potential and realized changes in arrears.

Unfortunately, when it comes to including performance criteria on government arrears in Fund programs, it has been argued that two types of problem need to be overcome. The first arises from the practical accounting problems often found in developing countries. Specifically, the experience of Fund programs suggests certain preconditions for a truly operational performance criterion with respect to government arrears are not always met: a clear and mutually agreed definition of arrears; a complete inventory of the existing stock of arrears based on this definition; and a timely method of monitoring changes in this inventory.

The second main difficulty is perhaps more serious and is generally faced by all performance criteria insofar as their successful operation depends on the cooperation and good faith of the authorities. The presumption exists that the authorities view a performance criterion as an acceptable indicator of the degree of adjustment to economic targets and as a signal of success or failure in meeting these targets. In the past, the stress on the connection between

meeting performance criteria and Fund drawings has frequently meant that performance criteria, like those on government arrears, have not been viewed primarily as a guide to economic policy but as a hurdle to be overcome. In such an environment, instituting a performance criterion on government arrears may be undesirable, since it may tend to put pressure on the authorities to subvert established accounting procedures.

In light of this potential danger, this paper has recommended that the direct approach to programming arrears performance be combined with an appropriate monitoring system for broad aggregates of government expenditures with targets subject to the usual mid-term review. Ideally, to be effective, this monitoring system should be placed on continuous review basis, with arrears prevention as its primary concern. In this way it may be possible to detect deviations from the program at an early stage, allowing more timely corrective action. It has been noted that in several countries such an indirect approach has been adopted with a degree of success for external arrears, by programming and monitoring transfers to special blocked accounts for external debt service as a performance criterion.



Office Memorandum

TO: Mr. Heller

March 14, 1986

FROM: W. A. Beveridge

SUBJECT: Draft Paper on Government Arrears
in Fund Adjustment Programs

I am unhappy with the impression that is conveyed in this paper that the limits involved in Fund programs on credit to government lead to the emergence of arrears. Government spending tendencies are not inevitable. Many readers of this paper will gather the impression that Fund programs are ineffective and that credit limits are not relevant. I believe any impression along these lines should be removed from the draft.

I am attaching some more detailed comments prepared within the Stand-By Policies Division.

Attachment

INTERNATIONAL MONETARY FUND

March 14, 1986

Mr. Beveridge:

Per Mr. Brachet's request, I prepared the attached comments on the draft FAD paper on government arrears in Fund programs.

Attachment

cc: Mr. Quirk

PN

Paulo Neuhaus

~~SP~~ *no* *EP* *W* *O*

INTERNATIONAL MONETARY FUND

March 17, 1986

Mr. Heller:

Herewith some further comments. Please note the general concern about the implications of your draft paper for the way the Fund ceilings are interpreted.

WAB

Attachment

W. A. Beveridge

[Vertical line and marks on the right side of the page]

INTERNATIONAL MONETARY FUND

TO : Mr. Beveridge March 14, 1986

FROM: Peter J. Quirk 

Attached are comments on the FAD paper on government arrears, mainly on those parts dealing with external arrears. In view of the very cursory, and at times ill-informed, discussion of external arrears we think that the paper would benefit from being explicitly on the domestic aspects--on which it makes some interesting and useful points.

However, I believe that this paper, although not containing "conclusions" section per se, has a number of policy observations--most of which are seriously flawed. The general thrust of the paper would be counterproductive in that it would provide arguments against some of the more basic elements of Fund programs and jurisdiction. In my opinion, it needs major realignment before issuance should be considered.

Attachment

cc: Mr. Brachet/Mr. Neuhaus

coFADpaper

Government Arrears in Fund Adjustment Programs

As a general comment, this paper should be more specific as to whether or not at various points it is dealing with domestic or external arrears. For example, the discussion of 17 countries in Section II and their performance under programs relates entirely to domestic arrears, but this is unclear in the drafting. We would suggest that Section II be entitled "Quantitative Significance of Domestic Arrears," and that the heading to the paper be retitled "Government Domestic Arrears in Fund Adjustment Programs," in view also of the actual content of the other sections of the paper, as noted below.

Page 6: The discussion of accounting procedures leading to identification problems in arrears is based upon a distinction between the French and British systems. We would suggest that the accounting systems are not the relevant factor in whether arrears are "domestic" or "external." Rather, this derives from the common central bank, because access by each government to central bank borrowing must be distributed when a shared institution is involved. For this reason, we think that much of this discussion is misplaced; the arbitrary introduction of Liberia in line 9 of this page also points up the basic conceptual problem. We would note that the categorization of Liberia's arrears as "domestic" has been subject to ongoing discussion within the Fund staff.

Pages 8-12: The discussion of the steps between a decision to make an expenditure and final payment to the supplier under either of the French and British systems contributes little to the understanding of why such delays should arise. The emphasis that is put on the merits of

the French accounting system in identifying arrears would seem to be misplaced, as in a number of francophone countries there have been widely varying estimates over time of the amount of arrears in existence.

Page 14: It is noted here, in the third sentence from the bottom of the page, that the "composition" of expenditure can distort the definition of "normal" delays beyond the payment due dates, which constitutes the basis of identifying arrears. Because the concept of a normal delay as defined for Fund programs (see the various Executive Board papers on external payments arrears) relates to past performance in the overall execution of payments, it is difficult to see how this can be so. The composition of expenditure, as shown here, can affect the contracting of maturities by which payments become due, but it is not shown how this relates to subsequent delays, which are what matter for purposes of identifying arrears.

Page 15: We do not see why the existence of an amortization account for debt servicing should lead to a special "identification problem." If the account is known, then it can simply be incorporated for purposes of arrears data. Similarly, it is not clear that a "serious identification problem" should result from expenditures outside of the regular commitment, if the account for "depenses en cours de regularisation" is also analysed for arrears.

Page 18: The discussion in the paragraph at the bottom of the page and over on page 19 puts the cart before the horse--the debt rescheduling arrangement, have generally been a response to the emergence of arrears, rather than, as suggested here, a method of

avoiding incurrance of arrears.

Pages 19 and 20: The stage of the expenditure discussion appears to be important mainly for the identification of arrears data--a topic already dealt with at an earlier stage of the paper.

Page 21: The distinction drawn between external and domestic arrears on the basis of whether the claim is denominated in local or foreign currency is incorrect. The statement that external arrears typically coincide with balance of payments difficulties, and domestic arrears with fiscal problems, is meaningless, because balance of payments difficulties typically coincide with the budgetary imbalances. For similar reasons, Chart 2, which purports to show a distinction between external and domestic arrears is in part incorrect, and an oversimplification--members with sufficient budgetary and exchange resources may yet incur arrears (e.g. Venezuela for the latter). This chart, by the way, shows Fund programs as a cause of arrears!

Page 27: It is not clear why the accounting treatment of external payments arrears and rescheduling is cited as a presentational problem as the relevant identities are quite straightforward (see EBS/82/57 p. 12).

Page 37: For the reasons cited above, the discussion of the distinction between external and domestic payments arrears is incorrect.

Page 38: The second full paragraph notes the difficulties of statistical identification of domestic arrears for purposes of Fund programs. A problem with the subsequent discussion is that it does not suggest solutions to the difficulties, but rather argues that an arrears reduction should not be sought under the program because such a

reduction could result in the government issuing paper rather than discharging its commitments in cash, with inflationary consequences. However, issuance of government paper would normally be covered by other performance criteria in the program, therefore, an inflationary problem need not ensue. It is preferable that the problem be put into the recorded sector by having the irregular payments normalized through regular financial instruments.

Pages 42, 43: It would be interesting to know the identity of the "francophone" country cited at the bottom of page 42 to ascertain what it was in the performance criterion that led to its ineffectiveness. One could imagine that the performance criterion was insufficiently comprehensive in definition. Similarly the problem in "an anglophone country" by which the arrears performance was affected by the Fund program credit ceiling would be interesting to follow through on. Here again, one would expect that if the arrears problem was of sufficient magnitude, it could not be "buried" by the window-dressing techniques pointed to.

Page 44, first paragraph: The problem is not one of maintaining the discipline of the accounting system in the face of performance criteria, but of obtaining better outcomes by working on both fronts simultaneously--data and performance criteria.

Page 44, second paragraph, and page 45: This discussion is very cursory, in view of the considerable attention already given to the topic in Fund papers. As the focus of the paper is on domestic arrears, it might be preferable to delete it.

March 14, 1986

Comments on Draft Paper on Government Arrears
in Fund Adjustment Programs

The paper is timely and informative but it also contains a number of misconceptions or inaccuracies that would need to be clarified and that are discussed below.

1. First, the paper conveys the impression that Fund programs or statutory central bank limits on credit to the government (which are typical in francophone countries) cause the emergence of arrears (e.g., pages 6-7, Chart 2 on page 22, page 43), on the assumption that the government's spending proclivities are inevitable and will be ultimately validated either by legitimate financing or arrears. A more acceptable formulation would be that credit limits in Fund programs (or domestic statutory limits on spending and credit to the public sector) obviously make it more tempting for members to resort to arrears in order to circumvent those limits, but here it would be important to introduce the notion that effective adjustment under a Fund-supported program requires mutual trust between the Fund and the member. This point is discussed at length in the papers on "Reporting and Other Problems on Performance Criteria in Fund Arrangements—Legal and Policy Issues" (EBS/84/94) and "Misreporting and Noncomplying Purchases Under Fund Arrangements—Guidelines on Remedial Action" (EBS/84/196), which should be included as a reference in the current paper.

2. Second, the paper's distinction between domestic and external arrears focuses mainly on the currency denomination of obligations and the possible existence of a foreign exchange constraint. Beyond these obvious points, it would be important also to mention that the Fund's interest in the avoidance of external arrears transcends the immediate problems of particular members. This interest instead is rooted in the broader concern of the Articles of Agreement in maintaining an open system of international trade and payments that avoids, *inter alia*, restrictions in the form of external arrears. Incidentally, while discussing domestic vs. external arrears on page 21 it would be useful to clarify that in currency union members the distinction between domestic and external arrears is lessened not because the domestic currencies are convertible (i.e., pegged to the French franc) but because union members enjoy virtually open-ended access to borrowing from the French Treasury. Otherwise, the existence of a fixed exchange rate would be consistent with a foreign exchange constraint. (The classical case for fixed exchange rates rested precisely on the financial discipline that it imposed on its adherents because of the risk of quickly running out of reserves).

3. Third, the paper dwells at length on the distinction between arrears on domestic amortization and on other domestic payments but we would disagree with the conclusion that arrears on amortization, unlike other arrears, do not affect income and expenditure of the rest of the economy (e.g., pages 17-18). As far as we can see, arrears are always a form of additional deficit financing and, because funds are fungible,

the first round impact would be the same irrespective of the underlying domestic transaction (i.e., amortizations vs. current or capital expenditures). To invoke differential impacts one would have to argue about differential spending propensities of the economic agents involved, e.g., bondholders, government suppliers, civil servants, etc., which may well exist but would have to be empirically established. 1/ The only meaningful distinction between arrears on transactions above and below the line seems to relate to presentational issues of the type discussed on pages 25-28. In particular, for transactions above the line there is a distinction between transactions on a commitment and on a cash basis, and assuming that there are reliable estimates of transactions on a commitment basis, the discrepancy with the cash transactions would reflect arrears. 2/ However, the fact that amortizations are always a cash transaction poses difficulties (of the type described in the paper) in detecting arrears. One possible avenue to address this problem could be to identify the difference between notional amortizations (before or after rescheduling, as the case may be) and actual amortizations as a financing item below the line (rather than as a memorandum item). Under this approach, in Table 2 (page 26) the entries for cash balance and financing in period t would remain unchanged but there would be an entry for "notional amortization" (-15) offset by an entry for "arrears on amortization" (+15).

4. From a presentational point of view the paper could be streamlined in a number of ways:

a. The introduction could be expanded by presenting arrears as a disguised form of deficit financing, which explains the need to limit them in the course of Fund-supported adjustment programs. The points discussed above, on the special considerations regarding the avoidance of external arrears and on the presumption of trust between the Fund and its members, could also be briefly alluded to.

b. Section II breaks the flow of the paper and could best be included in an appendix, perhaps by summarizing the main findings in the introductory Section I.

1/ To illustrate this point, consider a case where the public sector is in balance ex ante and where the only form of domestic financing is the sale of bonds. Assume that in the current period there is an unexpected revenue shortfall of 50. Under the circumstances, the government's impact on the economy would be exactly the same regardless of whether the shortfall were to be made up by running 50 of arrears to suppliers (e.g., by giving them dubious promissory notes) or by not discharging 50 of obligations due to bondholders.

2/ Another possibility nowhere discussed in the paper is the existence of "errors and omissions" akin to those in the balance of payments.

c. On page 23 the discussion assumes implicitly that the fiscal deficit is financed by domestic credit and foreign borrowing; it would be useful, for the sake of completeness, to consider also the existence of domestic nonbank financing.

d. In Table 3 (page 28), the suggested fiscal presentation could usefully include as a memorandum item total arrears (i.e., on interest and amortization).

e. The point made on page 29 (bottom), that in the presence of persistent arrears interest payments are likely to be underestimated, would seem to be true only if government suppliers marked up their costs for the implicit interest payments that offset the expected arrearage. One is puzzled by the statement at the bottom of the page and on page 30, that government interest payments would be underestimated even if such a mark up by suppliers did not occur and their profit margins were thus squeezed. This statement is also contradicted by the statement on page 35, that arrears to suppliers would be equivalent to the purchase by suppliers of government bonds at zero interest if they fail to mark up their prices.

f. Section VI on arrears in Fund programs could be enhanced by including a section summarizing the main conclusions of the paper.

Government Arrears in Fund Adjustment Programs

I. Introduction

Government arrears is a general term used to signify a government's undischarged obligations. It has long been recognized that measuring the magnitude of arrears is important in gaining a more realistic picture of the impact of government operations and the size of fiscal problems facing countries. As a result, the Fund has paid increasing attention to the problem of domestic and foreign government arrears, to the extent of including clauses specifically addressing this issue in various Fund programs.

The objective of this paper is to analyze the significance of the government arrears problem for Fund programs, with particular emphasis on how the problem may be identified, quantified, presented in fiscal tables, and integrated into policies of fiscal adjustment. In an Appendix (to be written) case studies are also presented 1/ on how the problem of government arrears has been dealt with in recent Fund programs.

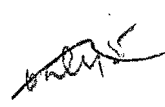
II. Quantitative Significance of Arrears

Of the 66 countries which had Fund programs in the period 1980 to mid-1985, a recent study (SM/85/113) has identified 17 as having specific problems with government domestic arrears which figured in their financial programs. Of these countries, 12 were African, 2 were from the Western Hemisphere, 2 were European, and one Asian. While it is not possible, due to problems of identification and quantification, to show

1/ Case studies of Morocco, Ivory Coast, Zambia, and Liberia.

the outstanding stock of government arrears in these countries, it is possible for comparative purposes to quantify those changes in arrears which have been identified when formulating these programs. Table 1 below shows changes in identified arrears relative to total government expenditure and total government financing. Cross-country comparisons of ratios on arrears are very hazardous, both due to varying definitions of arrears and because "identified" arrears undoubtedly understate to varying degrees the true magnitude of outstanding arrears. Moreover, due to changes in coverage, changes in definition, and institutional changes in recording arrears, it is highly unlikely that for any one country the time series is consistent, making inter-temporal comparisons difficult. Such qualifications imply that any conclusions drawn from these data must be couched in cautious terms.

Nevertheless, even from Table 1 the size and importance of the arrears problem can be appreciated. As is evident in (7) of the 14 countries shown in the table for which data are available, arrears have been increased or been reduced by the equivalent of 10 or more percentage points of total recorded expenditures. This represents a considerable impact on the rest of the economy emanating from this one fiscal item alone. Moreover, if we view the size of changes in arrears in relation to the overall financing requirement of the government, it can be seen that for all countries except one for which data are available, the change in recorded arrears has been



been 10 percent or more of total financing in at least one year shown in the Table. Moreover, for 11 out of the 14 countries, the change in arrears has reached 20 percent or more of total financing in at least one year, in four countries it has been over 50 percent in at least one year, and in Turkey in 1981 the increase in recorded arrears was equivalent to the overall government financing requirement.

Aside from its magnitude, the change in arrears has displayed a much greater degree of volatility over time than other fiscal aggregates. For example, consider the impact of such fluctuations in arrears on small economies such as Niger, which increased arrears in 1981/82 by 12.1 percent of total expenditures and reduced arrears by 12.6 percent in 1983/84; or Sierra Leone, which increased arrears in 1981/82 by 18.5 percent of expenditures and in the following fiscal year reduced them by 9.2 percent of expenditures. In part, these fluctuations in arrears have undoubtedly been imposed by the existence of Fund programs, but in part this volatility is also likely to reflect changes in recording procedures, changes in valuation (particularly if arrears are on external obligations), and in part also reflects the fact that changes in arrears often function as a "balancing item" in the fiscal accounts. Whatever the reason, the size of the change in arrears, coupled with its volatility, implies both considerable adjustment on the part of the private sector in accommodating such changes, and that for many program countries the elimination of arrears has posed a considerable problem for fiscal adjustment.

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volatile*

Table 1. Relative Size of Government Arrears in Program Countries

Country	Year	Change in Identified Arrears as Percent of	
		Expenditure	Financing
Belize	1983/84	+3.0	+16.0
Central African Republic	1982	+0.5	+4.9
	1983	+2.1	+14.1
Dominican Republic		...	...
Ivory Coast <u>1/</u>	1982	+2.2	+7.1
	1983	+10.1	+59.2
	1984	-7.0	-39.9
Liberia <u>2/</u>	1980/81	+1.9	+5.6
	1981/82	-1.6	-6.2
	1982/83	+2.1	+6.4
	1983/84	-2.1	-8.9
Madagascar <u>3/</u>	1980	-0.1	-0.2
	1981	-0.1	-0.3
	1982	-0.2	-0.5
	1983	-2.5	-8.2
	1984	-5.1	-23.9
Mali	1980	+4.0	+20.3
	1981	-1.2	-6.4
	1982	-10.4	-53.2
	1983	-9.7	-50.0
	1984	-4.9	-52.6
Morocco <u>4/</u>	1980	+1.1	+3.6
	1981	-0.5	-1.2
	1982	+6.3	+22.8
	1983	-7.7	-22.1
	1984	-0.9	-3.7
Niger	1979/80	+2.6	+9.1
	1980/81	+2.0	+4.6
	1981/82	+12.1	+47.1
	1982/83	-1.4	-3.5
	1983/84	-12.6	-29.0
Philippines		...	...
Portugal		...	...
Senegal	1979/80	+4.3	+35.0
	1980/81	+8.0	+28.4
	1981/82	-9.8	-28.0
	1982/83	+2.7	+10.2
	1983/84	-9.1	-32.9

Table 1. Relative Size of Government Arrears in Program Countries (concluded)

Country	Year	Identified Change in Arrears as Percent of	
		Expenditure	Financing
Sierra Leone	1980/81	+6.0	+15.8
	1981/82	+18.5	+42.3
	1982/83	-9.2	-15.4
	1983/84	+1.5	+3.5
Turkey <u>6/</u>	1980	+1.4	+6.8
	1981	+5.8	+100.0
	1982	-1.9	-16.6
	1983	+5.2	+53.5
	1984	+1.7	+6.6
Uganda <u>7/</u>	1980/81	+3.0	+4.1
	1981/82	+8.5	+26.0
	1982/83	+8.7	+32.1
	1983/84	-0.7	-32.4
Zambia	1980	+2.8	+9.6
	1981	-1.5	-4.1
	1982	-11.0	-22.7
	1983	+0.7	+3.0
	1984	+2.6	+11.5
Zaire	1982	+3.8	+12.5
	1983	+10.0	+109.2
	1984	+7.6	+171.1

1/ Coverage, nonfinancial public sector; also includes arrears on external amortization payments.

2/ Identified arrears up to 1984/85 include only arrears on interest. Expenditure up to 1984/85 is a mixture of checks issued and commitments, and deficits prior to this time may be underestimated because data on the accumulation of domestic arrears are unavailable. "Unallocated expenditures (net)" was 5.6 percent of the total cash deficit in 1980/81, 6.2 percent in 1981/82, 13.1 percent in 1982/83, and 16.4 percent in 1983/84. The latter is calculated as a residual, including unrecorded expenditure items, change in paycheck arrears, and check float, along with statistical discrepancies.

3/ Change in deferred payments, including payment of arrears.

4/ Change in fonds réservés.

5/ Includes arrears of central government and decentralized agencies (e.g., CPSP, SONAR).

6/ Change in accounts payable.

7/ Domestic arrears only.

III. Identification Problems

As the total of outstanding commitments the government has failed to discharge within a given period of time, the concept of arrears would appear uncomplicated. However, the identification of arrears is rarely straightforward because it depends on the accounting system of the country concerned. To illustrate, between the French and British accounting systems, a major distinction arises from critical differences in the institutional arrangements giving rise to the accumulation of government domestic arrears. In countries following French accounting practices, but also in Liberia, the main contributory factor has been the monetary arrangements or legal requirements which have limited a government's recourse to central bank credit. For example, in those Francophone countries sharing a common central bank, legal limits are placed on government's central bank borrowing, with the result that once that limit is reached, arrears become the balancing item between total commitments and other sources of finance. In countries following British accounting practices, legal limits on bank borrowing by the government rarely apply and because of this, the government typically has no difficulty in staying current in its obligations. Recently, however, domestic arrears have been evident in some of these countries, usually as a result of Fund programs which place limits on government domestic bank financing.

Similarly, past differences are evident between the two accounting systems regarding the reasons for the incurrence of foreign arrears. Indeed, while domestic arrears have appeared more of a problem for countries with French budgetary systems, foreign arrears have been considered more of a problem for those countries with British budgetary systems. Generally, domestic arrears reflect a shortage of local currency, while foreign arrears reflect a shortage of foreign exchange constraining the externalization of government payments to meet its foreign commitments. However, because many Francophone countries have access to the French treasury, the problem of externalization of payments is not the binding constraint in meeting their external obligations. Rather, for these countries the problem remains one of obtaining the local counterpart funds. As a consequence the distinction between domestic and foreign arrears is not clear-cut in many countries following the French accounting system.

If the reasons for the incurrence of government arrears differ in the French and British accounting systems, the means of identifying and quantifying arrears also differ. The British accounting system in its simplest form can be described procedurally as involving the following steps. First, after receiving authorization to spend, the Ministries or spending departments may enter into commitments with suppliers for the purchase of goods and services. These deliveries signify receipt of goods and services by the government, which is then liable for payment. Payment orders are usually prepared and issued by the receiving Ministry after certification that delivery

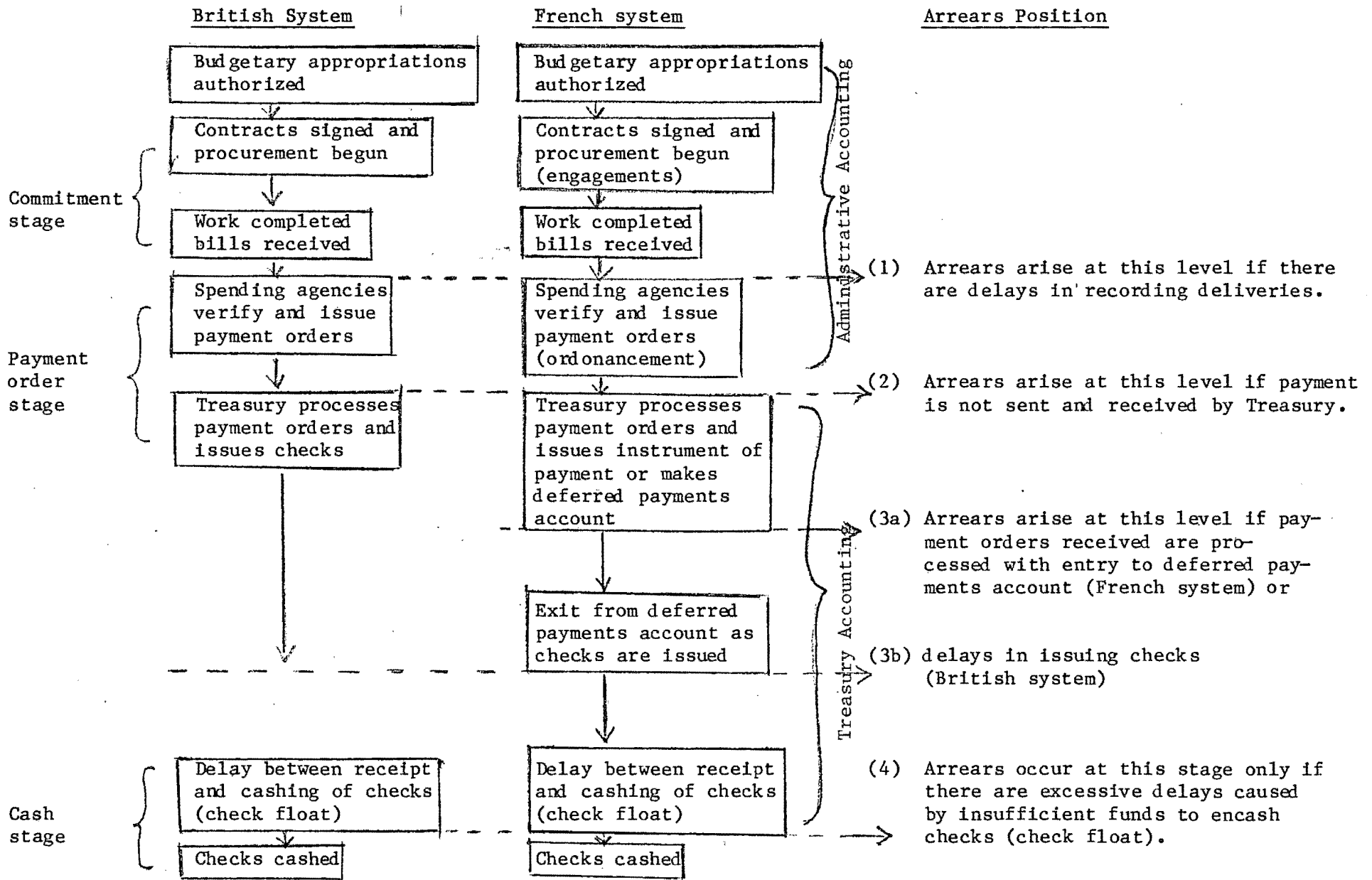
has been made. On the basis of these payment orders, checks or warrants are issued by the Treasury or the Ministry payment officers and sent to the suppliers. When these checks are presented at the banks, and the Treasury or Ministry accounts debited, the government can be said to have discharged its payment obligations. Normal delays in the government meeting these obligations obviously arise from inevitable time lags in the government's spending procedures. Typically, these delays occur at four points: in the recording of deliveries; in the issuance of payment orders; in the processing and preparation of payment checks; and in the actual issuance and release of checks (see Chart 1). The concept of arrears in this accounting system generally can be held to signify the existence of delays over and above some "normal" level, and can conceivably be measured at any of the above stages.

In an ideal world, with current data available on goods delivered, checks and payment orders issued and checks cashed, it would be comparatively easy to identify deviations from "normal" lags in the system. However, in many countries following the British accounting system the most current data available will be checks-issued expenditure data, so that it is only possible to identify a "check float" (i.e., the recorded difference between total checks issued and total checks cashed). In other cases, the only expenditure data available is likely to be either on a commitment (e.g., prior to deliveries) or on a payment order basis (e.g., subsequent to deliveries),

giving rise to a discrepancy between the latter total and the total of checks cashed. Consequently, only the total of unpaid obligations can be identified, part of which consists of the "normal" check float and the other consisting of those obligations which the government cannot or refuses to discharge (i.e., arrears proper). Thus, in the British accounting system, it is usually quite difficult to differentiate between the "normal" check float and arrears. Typically, some crude rules of thumb are employed to identify deviations of the check float from normal levels. For example, past levels of check float are often related to some other fiscal aggregate, say, the ratio between check float and total revenues or check float related to total expenditure plus check float.

Identification of government arrears in countries which have adopted the French budgetary and accounting system presents different problems. A common feature of the French system is the need to distinguish between two separate phases of the accounting system: the administrative accounting (comptabilité administrative) and the Treasury accounting (comptabilité du Trésor). While the administrative accounting covers the initial stages of expenditure implementation (from the point when goods and services are ordered until a payment order is issued), the Treasury accounting covers the financial phase (from the arrangement of payment through the discharge of the government's payment obligation). (For a comparison with the British system, see Chart 1.)

Chart 1. Arrears and Stages of the Expenditure Process



In the administrative accounting system, expenditures are first recorded as commitments (engagements) when a purchase order or contract is signed. Commitments are generally proposed by the spending agency and must be approved by the Ministry of Finance. After the service has been rendered or the goods delivered and the corresponding bill received, the spending agency verifies that the service was actually performed (verification) and establishes the exact amount of the claim (liquidation). Then a payment order is prepared by the spending ministry and sent to the Treasury (ordonancement). This is the last stage at which expenditures are recorded in the administrative accounting system. Normally, the payment orders are recorded by budgetary items.

The Treasury executes the financial phase of the expenditure process and records this in its accounts. The monthly statement of accounts (balance générale des comptes du Trésor) shows the position of each account and their movements from the beginning of the fiscal year. 1/

After a payment order has been received by the Treasury and acknowledged as valid (visement), the expenditure is recorded in the accounts of the Treasury, thus debiting the expenditure account. The counter entry can be made in various accounts, depending upon the manner and the speed with which the government discharges its payment obligations; frequently, a financial account or a third party account (if the

1/ These movements are the raw material for the processing of fiscal aggregates in the GFS statistics.

payment is to be charged directly to the payee's account with the Treasury) is credited. In many countries an important means of payment is the cash voucher (bon de caisse), used either for expenditure on personnel or goods and services. The cash voucher can be cashed at the Treasury or at any local branch. The cash vouchers are used not only for general budgetary expenses, but also for extrabudgetary accounts and local governments.

The Treasury may decide to defer payment on payment orders received, which are otherwise perfectly regular and valid. In this case the credit entry is made in the deferred payments ("virements différés," "fonds réservés") account. When payments are actually made, these accounts are debited by the credit of the financial account concerned. A special kind of deferred payments account is the account for expenses to be settled in the following month. This account operates as follows. Suppose a payment order pertains to December but payment is made in January. In December the payment order is debited to expenditure and a counter-credit is made to the account for expenses to be settled in the following month. In January the account for expenses to be settled that month is debited and a financial account credited. After the January accounts are closed, both entries in the account for expenses to be settled will be merged and the account balanced. Meanwhile, however, when considering December final accounts, one finds a credit balance to the account for expenses to be settled next month, which is typically treated as an outstanding payment arrear.

Thus, in the French system it is relatively easy to identify government arrears regarding the expenditures that have entered the accounting system of the Treasury. One has only to take the balances of the accounts which record expenditures that are to be paid. This typically includes the deferred payments accounts and the account that records the outstanding amount of cash vouchers. In many countries, experience shows that the deferred payments accounts have been frequently used as balancing items between expenditure commitments and available financial resources.

Arrears, as reflected in the outstanding amount of cash vouchers, differ somewhat from other Treasury arrears. The instrument of payment has been issued and it is up to the payee to present these vouchers to the cashier in the Treasury. Thus the Treasury has no real control on the amount of outstanding cash vouchers and the outstanding amount of cash vouchers should not exceed the normal float. However, the situation is different if the Treasury keeps on issuing cash vouchers but does not accept them if presented to the cashier. Because cash vouchers are untransferable, the holder of the cash voucher has no choice but to wait until the Treasury has sufficient financial resources to discharge its obligation. If the cash voucher were transferable, it could easily become a means of payment and would increase domestic liquidity. Such a situation has in recent years arisen in Liberia, a country which in most respects follows the British accounting system, where checks were released in excess of financial resources. Consequently, government checks started to circulate at a discount in the economy as a means of payment.

As with the British system, the identification of arrears is further complicated by delays in processing incoming bills prior to the issue of payments orders (e.g., recorded expenditure commitments awaiting issue of a payment order). At this stage of the expenditure process, arrears are not reflected in Treasury accounts, but only in the administrative accounting system. They can be measured only with information from spending agencies on the amount of unprocessed bills, a comparatively difficult and time-consuming procedure.

In both systems, the basic question of timing, central to identifying when a delayed payment constitutes a true arrear, is further complicated in practice by other features of government payment procedures. For example, the government may enter into commitments with suppliers for the immediate purchase of goods and services or into contracts providing for future delivery. In the latter case these contracts give rise to government liability for payment at some future time, generally set out in the purchase contract. Indeed, in the case of capital projects there may be significant lags between the delivery of goods or completion of work and when the government's legal obligation to pay becomes operative. In this way the composition of expenditure can distort the definition of "normal" delay in payment. In some countries the difficulty has been compounded by domestic contractors offering the government what amounts to suppliers' credits. Furthermore, if difficulties are encountered in identifying when delay in payment can be regarded as an arrear, there are also problems in defining the time period when

the government's delay in payment has become so protracted as to constitute a default.

Serious identification problems also arise for those expenditures which have been committed outside of the regular commitment process and which have not yet been recorded in the administrative accounting system. In some countries arrears of this nature have been reported as expenditures yet to be regularized ("depenses en cours de régularisation"). They often reflect extrabudgetary expenditures and expenditure overruns, the latter stemming frequently from unrealistic provisions in the budget. Instances of underbudgeting (e.g., electricity, telephone, and water) are sometimes the result of government inability to take necessary adjustment measures while the budget has to balance by law--at least on paper.

A special identification problem may arise with respect to arrears on debt service. A number of francophone countries have established amortization funds to manage the servicing of government debt. In this case debt arrears are reflected neither in the Treasury accounts nor in the administrative accounting system, but must be obtained from the accounts of the amortization fund.

To sum up, a basic difference between the two accounting systems in terms of identifying arrears arises from the degree of centralization in the processing of expenditure data. Therefore, both accounting systems offer indicators of changes in arrears that fulfill the criterion of being available without major operational difficulties, but these differ significantly in terms of the coverage of the expenditure

process. In the French system, expenditures are centrally recorded as soon as delivery is made and the claim is examined and judged appropriate and legal, even though no check has been issued. Hence the French system, when functioning properly, offers a direct, although perhaps incomplete, indicator of arrears relatively early in the expenditure process. This is defined as outstanding unmet commitments and is measured at the level of the Treasury.

The British accounting system, on the other hand, does not offer this intermediate indicator of changes in arrears. A comparison of actual deliveries with payment orders issued typically is likely to be done only in a piecemeal fashion by the spending departments as part of their day-to-day operations. To consolidate such data usually requires a special exercise. As a result, to estimate the change in arrears under the British system, one typically must rely on the change in "checks float," which may only be a small part of arrears. However, it should be noted that though the French system offers a more comprehensive indicator of arrears, it may also only reflect a part of total arrears. In Morocco, for example, the recorded stock of arrears at the level of the Treasury dropped by about 50 percent in 1983. However, a subsequent inventory of payment arrears showed that the total amount of government arrears had not changed. While payment orders issued awaiting settlement had decreased, payment delays at an earlier stage of the expenditure process had increased.

IV. Taxonomy of Government Arrears

To identify and address the problem of government arrears, it is useful to develop a taxonomy by which to classify arrears. The following criteria are useful: (1) the economic type of payment to which the arrear relates; (2) the stage of the expenditure process at which the arrear is incurred; (3) the payee to whom the payment is due; and (5) the denomination of the claim on the government.

1. Economic type of payment

The government may create an arrear with respect to expenditure on goods and services, transfer payments, or amortization payments. A government expenditure normally comprises two corresponding flows between the government and the rest of the economy: a physical flow of goods and services to the government and a flow of money to the rest of the economy. When the government excessively delays its payment and thus the flow of money to the rest of the economy, an expenditure arrear is created. Thus, while the government initiates an income-creating flow of goods and services from the rest of the economy to the government, there is no reverse injection of money into the economy. Government transfer payments do not involve a flow of goods and services to the government, but like expenditures on goods and services, add to the income of their recipients. If transfers are postponed, the income of the beneficiaries increases only on an accounting basis, not on a cash basis. Amortization payments do not affect the income of the rest of the economy, but result in the substitution of money for a claim on government. If amortization

payments are delayed, this liquidation does not occur and instead, a formal claim on government is replaced by a more uncertain one, reflecting the arrear. Thus an expenditure arrear, that is, an arrear on the purchase of goods and services or an arrear on transfer and interest payments, reflects an income creating process as well as an increase in claims on government in the financial portfolio of the rest of the economy. On the other hand, an arrear on amortization payments only leads to the substitution of a formal claim on government by a more uncertain one in the portfolio of the rest of the economy.

This difference between amortization and expenditure arrears has led to additional differences in statistical presentation, as discussed in Section V below. For presentational purposes, amortization arrears should be divided into two categories: arrears due to banks and nonbank arrears. Unpaid amortization payments on domestic government debt held by domestic banks are typically counted automatically as part of the banks' claims on the public sector (i.e., automatically refinanced) and therefore usually appear in the monetary data as net claims on the public sector. Including them as arrears in the presentation of the fiscal accounts would result in double counting the same source of domestic financing, and thus arrears to banks should not be shown in the presentation of the fiscal accounts, except as a memorandum item.

As for expenditure arrears, arrears on interest payments, particularly on those due to foreign creditors, have recently become prominent. Debt rescheduling arrangements by the Paris Club, including interest payments, have helped limit the incurrence of foreign interest

arrears. Arrears on wages, which account in most countries for a large share of recurrent expenditure, are seldom incurred, due mainly to political reasons. In Liberia, however, the government deliberately accumulated paycheck arrears in 1982, as a policy to reduce the wage bill. The government preferred to implement a cut in the wage bill by progressively stretching out the period between wage payments rather than by explicitly cutting wages. Arrears on investment expenditure are related mainly to the domestically financed component of expenditure, reflecting an overambitious investment program, an unexpected shortfall in foreign financing, or public enterprise investments undertaken on behalf of the central government, who then cannot reimburse enterprises for these investments.

2. Stage of expenditure process

As described in the previous section, there are four distinct stages in the expenditure process at which the delay can occur and which may be responsible for the incurrence of an arrear (see Chart 1):

- a. after the delivery of goods and services but prior to recording these services as a commitment;
- b. commitments awaiting issue of a payment order;
- c. issued payment orders awaiting the issuance of an instrument of payment; and
- d. issued instruments of payment awaiting actual disbursement of funds.

The above classification is significant for a number of reasons. Most importantly, the identification and measurement problems vary strikingly among the four categories. For example, under the French system,

the amount of payment orders awaiting settlement can usually be obtained easily from the Treasury accounts, while the identification and measurement of arrears at an earlier stage of the expenditure process typically poses enormous problems. A second important factor affecting the behavior of the payee is whether or not the instrument of payment has been issued, especially if the instrument of payment is transferable, as is the case with checks. Consequently, one can expect different economic effects from arrears in the form of an increasing check float as opposed to non-issuance of checks.

3. Arrears by payee

The government may create arrears to the private sector or to other units within the public sector. Experience shows that if governments respond to spending pressures by accumulating arrears, they begin doing so vis-à-vis other public sector entities; for example, by not paying utility bills. However, insofar as public enterprises are owned by the government, arrears vis-à-vis public enterprises do not affect the overall financial position of the government. Also, if one takes a broader view encompassing the entire public sector, as is often done in Fund programs, such arrears are consolidated. Of course, insofar as the public enterprise has minority private shareholders, or is making losses financed outside government, or as a result of government arrears is forced to build up arrears with its suppliers, the impact on the rest of the economy may not be negligible. Arrears to the private sector have often induced the private sector to hold back tax payments, creating tax arrears. This has sometimes resulted in a log-jam of interlocking arrears throughout the economy.

4. Domestic versus external claims

Another important distinction is that between domestic and external arrears. The criterion for this classification is whether the government can discharge its obligations by using local or foreign currency; that is, whether the claim on the government is denominated in local or foreign currency. Typically this distinction coincides with the payee's status as a resident or nonresident.

The existence of domestic or foreign arrears usually reflects a corresponding shortage of domestic budgetary resources or foreign exchange. External arrears typically coincide with balance of payments difficulties; domestic arrears, from a budgetary imbalance. This distinction is lessened if the domestic currency is convertible. In this case, the externalization of payments is no longer a constraint and both domestic and external arrears reflect a budgetary problem, as in the case of countries belonging to the West African Currency Union (CFA franc area). ^{1/} In countries where government revenue is sufficient to cover expenditure or where the central bank is authorized to extend credit to the government as needed, but where there is a shortage of foreign exchange, the externalization of payments rather than the domestic counterpart poses a problem. In such countries blocked accounts for the domestic counterpart of external obligations have been found useful. (For a discussion of the use of these accounts, see Section II.)

The matrix below summarizes the issues related to the distinction between external and domestic government arrears.

^{1/} For this reason, the Paris Club assesses the debt relief requirements of these countries on the basis of budgetary data, not on the basis of balance of payments data.

Chart 2. External and Domestic Arrears

		Convertible Currency	Nonconvertible Currency
Budgetary Resources Sufficient		No Arrears Problem	Only External Arrears Problems Blocked Account an Issue
Budgetary Resources insufficient, reflecting:	Monetary Arrangement (Liberia, CFA-Franc Countries)	External and Domestic Arrears Problem	External and Domestic Arrears Problem
	Fund Program		

V. Presentational Problems

An analysis of the sources, financing, and magnitude of government deficits is central to a fiscal presentation aiming to provide accurate insights into the impact of government operations on an economy. In the Draft Manual on Government Finance Statistics such analysis is made according to the following definition:

$$\text{Fiscal deficit} = (\text{Revenue} + \text{Grants}) - (\text{Expenditure on Goods and Services} + \text{Transfer Payments} + \text{Net Lending})$$

If the deficit is to be fully compatible with data in the monetary survey and the balance of payments, all components are to be measured on a cash rather than an accrual basis. Arrears are not treated explicitly, but are at best shown as a memorandum item. However, while such a definition captures the monetary impact of the budget, it does not--in the presence of arrears--fully capture its income-creating impact. Expenditure measured in cash terms will exclude any buildup of arrears, even though the latter signifies increased government use of the country's resources, which in turn has set in motion corresponding income-creating effects. If the Government purchased goods or services, the accumulation of arrears has most likely had an impact on incomes and on domestic credit expansion, with the government financing its deficit through an expansion of suppliers' credits. In terms of policy, the credit expansion should be correctly attributed to the originating sector.

Recognizing the importance of such distortions when formulating policy, two alternative presentations have been advocated to overcome the drawbacks of a purely cash basis fiscal presentation in the presence of arrears. First, expenditures have been shown on a commitments basis and the difference between total cash financing and the resulting deficit, the change in arrears, shown as a financing item. Unfortunately this has meant that total financing, by including a noncash component, is not immediately reconcilable with monetary statistics. The second approach is to show the overall deficit on a commitments basis, with separate lines for the net change in arrears and a corrected overall deficit on a cash basis, i.e.,

- a. total revenue and grants (cash basis),
- b. total expenditure (commitment basis),
- c. (a - b) overall deficit (commitments basis),
- d. net change in arrears,
- e. (c + d) overall deficit (cash basis).

This approach encounters a number of practical presentational problems:

- a. Combining estimates with actuals

The above presentation depends critically on the ability to identify and quantify the change in arrears, and brings to bear some of the issues raised in Section III. In many cases all that is available, particularly in the British system of accounting, is the change in "check float." The question then arises whether this change could

be considered "normal," in which case it should be excluded from the presentation of the fiscal accounts, or whether it indicates a significant change in arrears. This question was addressed in Section III, where rules of thumb, necessarily of an approximate nature, were suggested for judging whether a change in check float should be considered "normal." In other cases specific arrears (e.g., on external debt service payments) can be identified, but the total change in arrears may be difficult to quantify. In these cases an arrears line is shown as "identified arrears," and when the arrears on amortization payments can also be identified, these can be shown as a memorandum item with total identified arrears divided into their expenditure and amortization components.

b. Treatment of arrears on amortization

The suggested fiscal presentation does not explicitly treat government arrears on amortization payments, because all financing items are shown on a cash basis. However, arrears on amortization payments, as has been argued above, appear different in their impact on the economy than arrears on interest payments or arrears on other recurrent expenditure. Unfortunately, given the constraint of having to show financing items on a cash basis, there is no way to represent these arrears in the above fiscal presentation except as a memorandum item. This can be illustrated by the following example. Let us assume that in period t the government spends 10 units on goods and services but does not pay for them and a debt amortization payment

of 15 also falls due, which the government is unable to honor. In period t + 1, the government receives 25 units in revenue and discharges all its overdue obligations. The fiscal presentation should reflect these financial obligations as follows:

Table 2. Summary of Government Operations
(In domestic currency units)

	Period t	Period t+1
Revenue	0	+25
Expenditure	10	0
Overall balance (commitment basis)	-10	+25
Change in expenditure arrears (- decrease)	+10	-10
Cash balance	0	+15
Financing	0	-15
Repayment of amortization arrears	0	-15
Other	0	0
<u>Memorandum item:</u>		
Change in amortization arrears	+15	-15

c. Changes in commitments during the financial year

Because arrears are defined as the difference between the government's commitments and its discharge of these obligations in a timely fashion, problems are encountered in presenting the change of arrears when commitments change during the fiscal year. Such changes may arise from exchange rate revaluations and debt rescheduling agreements. In the latter case, it is important to quantify the exceptional financing to the budget arising from debt rescheduling and present such

financing as a memorandum item. The difference between total commitments after debt rescheduling and discharged rescheduled commitments is the change in arrears shown in the relevant line of the fiscal table.

An example illustrating some of these presentational problems is the case of the 1984 fiscal outturn for Zambia. During 1984 the Government benefited from debt rescheduling which lowered its debt servicing commitments. Despite this, in 1984, it also accumulated arrears both with respect to rescheduled foreign interest and amortization payments. The situation is described in the following table:

	<u>Debt Service Commitments</u>		Actual Debt Service Payments	New Arrears
	Before rescheduling	After rescheduling		
	<u>(In millions of kwacha)</u>			
Interest	140	72	32	40
Principal	253	127	68	59

In this case arrears on interest payments are shown as the difference between the deficits on a commitment and cash basis, and arrears on amortization payments as a memorandum item. It is also helpful to show the change in commitments over the year and this is accomplished by showing the exceptional financing obtained as a result of debt rescheduling as a memorandum item. The suggested fiscal presentation would be as follows:

Table 3. Zambia: Provisional Outturn, 1984

	<u>Millions of kwacha</u>
Total revenue and grants	1,170
Total expenditure and net lending	1,556
Overall deficit (commitments basis)	-386
Change in arrears on external interest (increase +)	40
Overall deficit (cash basis)	-346
<u>Memorandum items:</u>	
Estimated arrears on foreign amortization	59
Estimated reduction in debt services payments as a result of debt rescheduling	194
Of which: Interest	(68)
Amortization	(126)

VI. Economic Effects of Government Arrears

In this section, we will discuss the effects of government arrears on the allocation and distribution of resources and on macroeconomic stabilization.

Important allocational effects of government domestic arrears include the following. First, if forced taxation through the printing of money is not feasible, the government's share in total output is limited by the amount the rest of the economy is prepared to release to the government by paying taxes or by extending credit to the government. The buildup of arrears increases the government's absorption of resources above this level. This initial effect may be offset by the rest of the economy limiting resources transferred

to government by holding back on tax payments and other fees and charges. Equally important, when the government incurs arrears, those economic agents providing goods and services to the government may begin to adjust their pricing and production behavior to take account of such payment delays. Vendors dealing with the government may begin to charge higher prices to make up for refinancing costs, a risk premium, and bribes to speed up the payment process. Thus the government may have to pay prices above the market price or, alternatively, with limited budgetary outlays, purchase reduced quantities of goods and services. The shortfall is likely to be determined by the vendors' expectations about the length of payment delay, the prevailing interest rate, the risk that the government will default, and the amount of bribe necessary to speed up the payment process. Similarly, there is also a possibility creditors will bid up interest charged on loans to the government if they anticipate that the government will not pay back these loans as scheduled.

Consequently, it follows that aside from the interest payments on government debt explicitly shown in the budget, there are implicit interest payments hidden in those expenditure items on which arrears have frequently been incurred. Thus, when explaining the composition of government expenditure, it is well to remember that in the presence of persistent arrears, interest payments are likely to be underestimated. These implicit interest payments are independent of whether or not providers of goods and services bid up prices to

account for the delays in payment. The increase in prices only determines who will bear the financial burden of the payment delay--the government by paying increased prices (and ultimately the consumers of its services through reduced services or higher taxes or fees), or the vendors through a squeeze in their profit margins.

Arrears on wages and salaries, implying a cut in wages and salaries paid to civil servants, are also likely to have an important economic impact. In cases where the level of government wages is significantly higher than the wage level in the rest of the economy, such a cut may be desirable both on allocational and distributional grounds. Conversely, where government wages are relatively low, wage arrears may impair the government's productivity, have adverse distributional effects, and provide incentives for corruption as well as for the acceptance of outside jobs.

As for the macroeconomic effects of government arrears, it is important to evaluate how government arrears are created and how the payee reacts to payment delays. For example, the change in aggregate demand brought about by the creation of arrears to government employees will depend largely upon their perception of the postponement of wage payments and their underlying consumption behavior. If, for example, the spending decisions of government employees are dominated by their actual cash income, and if the government stretches out the period between paydays so that the civil servants receive only 11 monthly salaries in a 12-month period, then their private consumption will drop by 1/12. However, if their underlying consumption behavior

is more accurately described by the permanent income hypothesis of consumption behavior and if government employees regard delays in salary payment as only transitory, civil servants may perceive only the interest foregone on the deferred payment as a cut in permanent income. Their consumption outlays would then drop only marginally, and the temporary cash shortage would be made up by dissavings. If the civil servants, however, do not have confidence in being able to recover the loss in cash income incurred by the payment delay, the drop in their permanent income will be considerably more than just the foregone interest, and private consumption will fall accordingly.

A similar analysis can be applied to other government payments to private households. Delays on transfer payments to private households and on interest payments on government bonds held by the private nonbank sector will tend to reduce private consumption. The size of this fall will be determined by the relevant consumption function and the perception of the private household as to whether the payment delay represents a transitory or permanent change in government policies.

In its normal purchases of goods and services from vendors, the government sets into motion an income-creating process that increases aggregate output. The effects of the government's incurring arrears in payments will depend upon the way vendors prefinance the production of goods and services purchased by the government. If this prefinancing takes the form of borrowing from the banking system, the impact

will be no different than if the government had made the payment on time with proceeds borrowed from the commercial banks. Thus the overall effect on aggregate demand will be very similar to the one from bond financed government expenditures. Alternatively, vendors might perceive the incurrence of government arrears as only a temporary phenomenon and thus reduce their cash balances below the level warranted by the prevailing interest rates and their volume of transactions. In this case, the increase in government expenditure would be financed by a higher velocity and aggregate demand might increase. A similar strong demand effect may be expected if vendors satisfy their financing needs by external short term indebtedness. In some countries, companies have adjusted to the government's inability to meet its obligations by creating arrears to the foreign parent company. In this case, the government has indirectly financed its expenditure by an inflow of foreign short-term capital, with a concurrent improvement in the overall balance of payments.

Finally, it has been observed that companies frequently adjust to the emergence of government arrears by incurring arrears on their tax liabilities. Insofar as the vendors not paid by the government in turn retain taxes owed to the government, the government in practice is financing its expenditure by foregoing tax revenue, such that the macroeconomic effects are similar to any other tax-financed expenditure.

Two additional aspects are worth mentioning. First, if the creation of arrears takes place at a very late stage of the expenditure

process by increasing the stock of outstanding checks beyond the normal check float, significant monetary effects can be expected. Because government checks are normally highly liquid, money creation takes place and, if the demand for money does not grow at the same pace, eventually this will create pressure on prices and on the balance of payments. Secondly, the accumulation of government arrears may have a serious impact on the confidence of private enterprises and households in the soundness of government financial operations. Private consumers and investors might anticipate increases in the nominal tax rate, inflation, or more generally, a deterioration in the financial situation of the country over the medium term. As a consequence, the expectation will be that permanent incomes and profits will drop, adversely affecting current consumption and investment expenditure.

Arrears on amortization payments are likely to differ significantly from expenditure arrears in terms of their macroeconomic effects. If the government fails to make a domestic amortization payment on time, the only immediate effect will be a substitution of a formal claim on government by another one, with the total amount of claims of the private sector on government remaining unchanged. This also assumes that government will continue to pay interest on the loan, and that the portfolio owner believes that the government will finally repay the loan. Typically, creditors might try to raise the interest rate somewhat in order to compensate for the higher risk now associated with this part of their portfolio. If on the

other hand, the government stops paying interest and so increases the probability of default, a domestic amortization arrear will lead to decreasing private sector wealth (assuming that the so-called Ricardian equivalence does not hold and that, therefore, government loans are regarded as net wealth by the private sector). ^{1/} When wealth is an argument in the consumption function, the creation of domestic arrears on amortization payments will tend to reduce consumption and imports. Serious balance of payments consequences can be expected from the creation of amortization arrears to external creditors, particularly in the medium term. In the period when the arrear is created, only the structure of the capital account changes and capital outflow is financed by the creation of arrears. In the medium term, however, the government's credit rating could be damaged and the inflow of official capital could very likely dry up.

Do government arrears have an impact on the rate of inflation? At first glance, it appears rather unlikely, because typically no money creation takes place at the time government begins to incur an arrear. However, there may exist indirect links between the buildup of arrears and the rate of inflation. First, as described above, suppliers are likely to react to the incurrence of government arrears by bidding up the prices at which they are prepared to sell goods and services to the government. In more general terms, in an environment characterized by financial instability as reflected by the government's inability to make payments on time, economic

^{1/} Under Ricardian conditions, the future taxes implied by government debts are fully perceived by the private sector and completely offset the private sector's claims on the government (see Schiller (FAD (1984))).

agents will include high risk premiums in the calculation of the price at which they are prepared to render goods or services. Secondly, if the provider of goods and services bridges the delay in payments by borrowing from the banks, this may add pressure to the credit market, and as in the case of additional government borrowing, push up interest rates. If this effect induces the Central Bank to relax monetary policy or attracts capital, the outcome would also be pressure on prices. Thirdly, if arrears are accumulated against public enterprises, as is often the case, the financial position of the public enterprise sector may worsen. If this results in higher credit from the Central Bank, arrears will end up creating inflationary pressures.

VI. Arrears and Fiscal Adjustment in Fund Adjustment Programs

The importance of arrears in any macroeconomic analysis of the impact of government should be evident from the discussion in the previous section. To sum up, at first glance it would appear that any delay in payment, as a form of compulsory financing of its expenditures, has significant benefits for the government. It is as if suppliers had brought government bonds at zero interest rate for the period until payment is made. However, the persistent use of such compulsory financing should be recognized as involving distinct drawbacks for the government as suppliers react by bidding up the prices at which they will provide it with goods and services. As a consequence the price government has to pay is inflated by the supplier's risk premium or implicit interest rate, increasing

the size of the government's deficit; and the general price level may be well raised. Any inflationary impact on the rest of the economy is likely to be exacerbated by suppliers having to incur increased credit to bridge the delay in payments. In this way it could be argued that the effect on the rest of the economy may differ little whether or not the government has actually paid a supplier, since the latter in all probability had to obtain credit and has definitely used resources to provide goods and services to the government whether or not the government has discharged its formal obligations to him. However, most important from the perspective of macroeconomic policy is to correctly attribute any monetary expansion to the initiating sector: in this case the government rather than the supplier should be recognized as initiating the expansion in credit. Similarly, from the financial programming viewpoint, the build-up of arrears by disguising the level of the government's use of resources lowers the recorded deficit and hence also the recorded credit to government.

By concentrating on the net effect of cash flows in the presence of the government accumulating arrears, the recorded deficit can remain constant while in fact the level of government spending is changing. This distortion has been recognized when formulating Fund programs where it has been judged important to capture not only the monetary effects of budgetary changes but also their income-creating or Keynesian impact (see Tanzi and Blejer, DM/83/44). The latter, which focuses on the impact of fiscal policy on the gap between domestic income and expenditures, would place emphasis on an accrual

rather than a cash definition of the deficit and would concentrate on the change in government commitments regardless of whether they were discharged in cash.

Operationally, in the treatment of arrears a distinction is usually made between external and domestic payments arrears. This arises in part because while the government discharges its debt service obligations in domestic currency, the final payment of external obligations has to be undertaken by the central bank as part of its management of foreign exchange. It is this feature concerned with the constraints on discharging obligations that has led to different treatment in Fund programs. Thus, while in the absence of a Fund program, government can in principle usually discharge its obligations in domestic currency, even though this means borrowing from the central bank, foreign exchange may not be available to discharge the central bank's corresponding external obligations. As suggested in Section III, an exception to this general rule arises in some francophone countries which operate a common central bank and have financing constraints placed upon them (see Chart 2). In these countries domestic arrears have been a recurring problem. While in Fund programs the general aim has been to avoid the distortions caused by arrears, whether they be domestic or external, the means of accomplishing this has in general been different.

Domestic arrears

In the case of domestic arrears a more direct approach has generally been advocated with a reduction in arrears programmed as a performance criterion. This approach was in response to some early programs where the change in "checks float," although only partially capturing changes in arrears, was excluded from domestic financing when calculating the ceiling on central government borrowing. Without a separate ceiling or a commitment to reduce these arrears, this item consequently became a buffer "cushioning" the restrictiveness of government credit ceilings and correspondingly tightening the credit ceiling in the rest of the economy. For example, if revenues did not rise as programmed, this could be offset by a smaller domestic arrears reduction.

Unfortunately, considerable operational difficulties and dangers have to be faced in this direct approach to the problem of arrears. To be feasible, programming limits on arrears as a performance criterion requires the existence of certain preconditions. In particular, there must be: (1) a clear definition of what constitutes an arrear, (2) a complete inventory of arrears based on this definition, and (3) a timely method of monitoring changes in this inventory. In practice, all three preconditions are difficult to meet.

In identifying domestic arrears difficulties usually arise in dealing with commitments, arising from dubious authorizations, which are yet to be regularized, or in isolating that part of the check float than can truly be considered as constituting arrears.

Compiling a comprehensive inventory of arrears has in practice proved difficult and time consuming, especially when they have arisen from government officials undertaking unauthorized expenditures. Thus in many cases the experience has been that originally agreed program limits on domestic arrears have been embarrassed by newly discovered arrears in the course of the program period. For example, a new methodology of quantifying arrears in the Ivory Coast suggested that public sector payment arrears had not been reduced by CFAF 40 billion in 1981, and by CFAF 61 billion in 1982 as estimated by a previous methodology, but had in fact increased. Similarly, the performance criteria regarding the ceilings in the level of domestic arrears had to be modified during the 1984-85 stand-by program with Niger when a new survey revealed a much higher initial level of outstanding arrears. In Togo, also, performance on domestic arrears in the 1981, 1982, 1983 programs was hampered by an inadequate inventory of arrears.

The data problems in some program countries have been so severe that although an arrears problem has been identified, because of inadequate data it has not been possible to include program commitments to prevent the incurrance of new payment arrears or the reduction of outstanding arrears. For example, without an inventory of past domestic arrears, it was impossible to establish a monitoring system for reducing these arrears in the Dominican Republic. Similarly, in the 1983-84 program with Portugal, despite recognition of the arrears problem, intractable data problems precluded the

quantification of their magnitude, adjustment for them in the presentation of the fiscal accounts, and inclusion of a performance criterion on arrears.

Even if this basic data problem can be overcome, to introduce performance criteria on arrears seems doubtful in the absence of an effective within-year expenditure or arrears monitoring system. Such a system is likely to take time to institute and may involve unacceptable reporting lags. Such a system would of necessity have to come to terms with the particular budgetary procedures of the country. To get a realistic picture of the movement in government arrears it has been found necessary to trace the changing stock of commitments, through the stock of payment orders to cheques issued and cashed, and have a reporting system at different stages of the expenditure process. (In the Appendix, the case study of Morocco contains a chart showing the possible recording stages for arrears, and the case study of the Ivory Coast illustrates a similar monitoring system adopted there.)

Even with the existence of these preconditions, introduction of a performance criterion on arrears would require a clear decision on what would constitute a legitimate reduction in them. For example, the government may attempt to reduce arrears by issuing government paper rather than discharging its commitments in cash. In such cases it seems necessary to ensure that the maturity of the bonds, the level of their interest rates, and the degree of their negotiability would not differ from that of other financial instruments. At the same time it should be recognized that the conversion of arrears

into government debt would be equivalent to any other rescheduling of debt in terms of its expansionary impact and would necessitate an equivalent reduction to any ceiling on credit to government.

Another factor that would arise in many countries is the problem of interlocking arrears. In these cases, while the government has undischarged payment obligations to a domestic supplier or enterprise, that enterprise in turn has unfulfilled tax liabilities to the government. The size of these mutual commitments is often in dispute, resulting in a bargaining situation with each side trying to gain advantage by writing off the larger outstanding obligation. Obviously from a financial programming viewpoint, the criterion on the reduction of arrears would be affected by whether the government's undischarged commitments were treated gross or net of tax obligations due to it.

In adopting a particular approach to monitoring performance criteria with respect to arrears, experience also suggests it is important to take into account the particular institutional characteristics of the country. Two particular institutional scenarios seem to be worth distinguishing. In the first, the Treasury is not in full control of the spending process so that powerful spending departments are able to make unauthorized commitments. In the second case, the Treasury does exert control over the spending process but does not honor commitments. In the former case the solution to the arrears problem may be institutional and difficult to resolve, being symptomatic of a more general

problem of expenditure control. For example, the geographic dispersion of government spending agencies is a severe handicap to expenditure monitoring and control in countries with acknowledged arrears problems such as the Philippines and Zaire. In cases where the Treasury's accounting system is sound, arrears are more symptomatic of a lack of political will to restrain public spending. Moreover, when faced with Fund performance criteria, the authorities, by having full control over the accounting system, are in a better position to hide arrears at an earlier stage of the expenditure process where they are less amenable to outside monitoring.

Overall, experience with past programs has led to the argument that the institution of performance criteria on arrears may be undesirable since they tend to put pressure on authorities to subvert established accounting procedures, which once damaged, may be hard to reinstate and with a consequent loss of policy information. This subversion has typically been accomplished by finding different ways to delay the recording of payment obligations or payments made. For example, a stand-by arrangement with one Francophone country included changes in the stock of fonds réservés as an additional performance criterion. Unfortunately, a detailed inventory of payment arrears established subsequently showed that the introduction of this performance criterion had only changed the structure of domestic arrears. Payment orders issued and awaiting settlement had indeed declined, while payment delays at an earlier stage of the expenditure process had increased.

It may also be possible to slow up the writing of checks, or when they have been written, to slow up their release. Even when checks are presented to the banks, there may be delays encouraged in discharging payment or in recording the debits from government accounts. A program in an Anglophone country, in particular, demonstrated how the scope for delaying the recording of payments presents problems when monitoring government credit ceilings. For example, it was possible for the government to issue a check for payment of its obligations, with the check being debited several days after the performance criterion test date. In several periods when performance criteria were to be observed, expenditure flows were clearly altered with the objective of attempting to comply with the net credit to government ceilings. In this way, a change in arrears was clearly a direct consequence of Fund program credit ceilings. 1/ Furthermore, it is not clear whether the methods which were instituted to control expenditures in the stand-by arrangement with this country may have increased the arrears problem. Under the expenditure control system, separate accounts for authorized capital expenditure and recurrent expenditure were established for each Ministry at the Central Bank, which was instructed by the Ministry of Finance not to permit overdrafts in any Ministry's account. To meet these monthly cash ceilings, spending ministries tended to delay issuing checks.

1/ The same is true for a number of other countries (Liberia, ...).

Recognizing that the cost of endangering the discipline of the accounting system may be far greater than the value of introducing such performance criteria, many programs have adopted an indirect approach to arrears. Thus instead of setting performance criteria on domestic arrears, it has been felt more desirable to design an appropriate quarterly monitoring system for broad aggregates of government expenditure with targets that would be subject to the usual mid-term review. The aim is arrears' avoidance rather than arrears control, providing an intermediate step, short of a performance criterion, which would allow policy discussions to take place at an early stage to put a program back on track. ^{1/}

External arrears

On the whole, external arrears, especially those with respect to debt servicing, have been more easily identified, inventoried and monitored. A less direct approach has been applied in Fund programs to limit the problem of external arrears. This has involved separating the domestic counterpart of foreign obligations from their actual externalization in order to prevent the accumulation of arrears on the domestic counterpart of external payments. In situations of foreign exchange shortages, a special blocked account for the domestic counterpart of scheduled official external payments has been found useful in some countries. Typically, programmed transfers to these accounts have been used as a performance criterion in Fund programs. The magnitude of such transfers has been calculated

^{1/} Programs which have incorporated this approach are the Gambia, Malawi, Sierra Leone, and Zambia.

so as to ensure that adequate provision is made from domestic budgetary resources for the domestic counterpart of such obligations, regardless of the availability of foreign exchange to complete the externalization of these payments. In this way some attempt has been made to limit the possibility of the government avoiding the restrictiveness of credit ceilings by not meeting external debt service commitments.

The use of blocked accounts has now been employed in a number of program countries (e.g., Mexico, the Philippines, Sierra Leone, Zaire, Zambia). ^{1/} Their use has been predicated on the existence of a fairly reliable schedule of debt service commitments. Although the 1985 program with a Latin American country did contain a commitment to set up a blocked account for the domestic counterpart of official external debt servicing payments, the precondition of a reliable schedule of commitments did not exist. Inadequate data regarding the extent of arrears, and the amount of domestic counterpart deposits already held by the central bank, delayed implementation. The experience with blocked accounts in other countries has been mixed, in some cases projected levels of debt relief from rescheduling were overestimated, in other cases further external commitments became known during the program period, and in at least one case counterpart deposits of the blocked account were not sterilized but used to circumvent government credit ceilings.

^{1/} For a more detailed discussion of this topic, see H. Bierman, "A Note on the Domestic Counterpart to External Arrears and External Debt Service" (FAD, 1985).



Office Memorandum

Mr. Finch

TO : Mr. Silard DATE: November 27, 1984

FROM : Peter J. Quirk

SUBJECT : Emergence of Arrears Not Subject to Fund Jurisdiction
During Programs in Support of Use of Resources

Mr. Clark of the U.K. Executive Director's office has informed us that the U.K. chair will, on the occasion of the Board discussion of upper credit tranche arrangements and conditionality scheduled for December 5, raise a question concerning the treatment in Fund programs of arrears not subject to Fund jurisdiction. He is concerned that, although this has not occurred to date, all new arrears that emerged in a country could be of this form, and the "standard" performance criterion would therefore not apply.

As a result of the approach endorsed in the recent Board discussion of "The Role of the Fund in the Settlement of Disputes Between Members Relating to External Financial Obligations" (SM/84/89, 5/15/84) there are now two instances in which certain arrears falling within the broad meaning of the quantitative program ceilings may not constitute an exchange restriction subject to the "standard" performance criterion:

1. When an entity of its own volition decides not to service an external financial obligation, whether or not the action is necessitated by a lack of financial resources; i.e., a "default."
2. Upon the signing of an agreed minute within the Paris Club or within commercial bank or suppliers' creditor groups.

In order to bridge this lacuna, a possibility would be to have all programs in future include within the standard performance criterion a specific clause along the following lines:

"(ii) introduces, or increases the level of, other external payments arrears or defaults."

In exceptional circumstances, where an initial or seasonal increase in the level of arrears was envisaged, the exception would be specifically stated in (ii). Similarly, the language in the quantitative criterion or criteria would refer to "arrears and defaults."

I would appreciate your view as to whether such an addition to the present standard performance criterion and the related treatment would be sufficient to deal with the eventuality that Mr. Clark is pointing to.

cc: Mr. Finch ✓
Mr. Kanasa-Thanan
Mr. Gerhard



Office Memorandum

TO : Mr. Finch

DATE: September 13, 1984

FROM : Peter J. Quirk

SUBJECT : Insurance Against Arrears

It is interesting that the distinction made for the purposes of Citicorp's innovative step of insuring its lending to developing countries is that made under Article VIII for arrears vs. defaults, i.e. "when the borrower has sufficient local currency available to make payments on a loan but is unable to obtain the dollars or other hard currency needed to actually make the payment"--Financial Times, 9/8/84.

It may be useful to note that Citicorp would be able, under the provisions of Executive Board Decision No. 446-4 of June 10, 1949, to request and obtain a Fund response as to whether or not the payments delays were inconsistent with Article VIII.

Attachment

cc: Mr. Beveridge
Ms. Dillon
Mr. Watson

Citicorp insures against debt delays

By Paul Taylor in New York

CITICORP, the largest banking group in the world in terms of assets, has bought \$900m (£692m) of insurance coverage against "prolonged delays" in receiving payments from private and public sector creditors in five financially-troubled less-developed nations (LDCs).

The insurance policy, written by Cigna, the second largest shareholder-owned insurance group in the U.S., covers Citicorp's loans to Argentina, Brazil, Mexico, Venezuela and the Philippines.

It is the first time a major U.S. banking group has bought private insurance to cover itself against all loans to a group of countries.

It could spark a wave of similar moves by the major U.S. banks whose shareholders remain deeply concerned over LDC debts.

Citicorp's innovative move was disclosed briefly in a footnote in its latest quarterly earnings filings with the U.S. Securities and Exchange Commission.

The footnote says the insurance cover will help protect Citicorp against the risk of major losses from prolonged delays in receiving funds because of a government's inability or refusal to make the foreign exchange available."

The policy does not cover default by either a sovereign or a private borrower. Instead it appears to be designed to offset possible earnings losses on either sovereign or private sector loans when the borrower has sufficient local currency available to make payments on a loan but is unable to obtain the dollars or other hard currency needed to actually make the payment.

Cigna, which yesterday confirmed it wrote the policy, is believed to have placed reinsurance for about 95 per cent of the policy's risk with other insurers, including Lloyd's of London.

While neither Cigna nor Citicorp was willing to provide specific details of the policy, it is believed to cover up to \$100m of Citicorp loans to Brazil and \$200m in each of the other four countries.

The insurance policy premium is believed to be about \$5m a year.



Office Memorandum

Mr. Fitch

MB

TO: The Acting Managing Director

August 15, 1984

FROM: Manuel Guitián *MG*

J

SUBJECT: Requests for Waivers Under Stand-By Arrangements:
Ecuador, Honduras, Liberia, and Zambia

↙

At the recent Board meeting (July 20, 1984) on Ecuador's request for a waiver of the performance criterion on external arrears under the stand-by arrangement that expired July 24, 1984, Mr. Mtei raised a question of uniformity of treatment among Fund members. In his intervention, Mr. Mtei contrasted the treatment of arrears in the case of Ecuador and Honduras with that given to Zambia and Liberia. In his reaction to this intervention, the Managing Director indicated that the Exchange and Trade Relations Department was responsible for the exercise of uniformity of treatment. He undertook to speak bilaterally with Mr. Mtei on this subject to clarify the circumstances in the cases that had been mentioned (see attached draft Board minute EBM/84/113, p. 41). For this purpose, the attached brief notes have been prepared on the treatment of external payments arrears in the arrangements in question, which you may wish to discuss with or transmit to Mr. Mtei.

Attachments

cc: The Managing Director (o/r)
Mr. Wiesner
Mr. Zulu
Mr. Collins

A Note on Treatment of Payments Arrears
in Selected Stand-By Arrangements

A caveat that applies generally to comparisons made among stand-by arrangements is that circumstances never are identical for all countries and therefore, comparisons to assess uniformity of treatment inevitably have to entail a measure of judgment. Not only circumstances vary among countries and with time but Fund policies also evolve in response to experience gained in the application of conditionality and changing conditions in member countries. As a result, what may be perceived as different treatment of countries at two different points in time does not necessarily imply that treatment of these members by the Fund has been uneven or arbitrary. This note addresses issues arising from a question that was raised recently at the Executive Board regarding the treatment of arrears in the cases of Ecuador, Honduras, Liberia and Zambia.

Three of the cases under review (Ecuador, 1983/84; Liberia, 1982/83; and Zambia, 1983/84) had a common feature from the standpoint of arrears. All three stand-by arrangements contained a performance criterion on payments arrears that was not observed. But aside from this similarity, there were also differences that explain the different courses of action that were followed. Specifically, in the case of Ecuador, a waiver was proposed and approved by the Board while in the cases of Liberia and Zambia, waivers were not proposed.

What was the position in Honduras?

A common characteristic of these cases was that the failure to meet the arrears criterion was due to causes beyond the members' control. In the case of Ecuador, a one-year stand-by arrangement was approved

in principle by the Board on June 1, 1983, pending assurances of financing from commercial banks. The period of the arrangement at this point coincided with that covered under a Paris Club agreement which provided for a rescheduling of maturities falling due through May 31, 1984. Negotiations with the banks were protracted and the stand-by arrangement did not become effective until July 25, 1983. As a result, the period of the arrangement extended approximately two months beyond that of the Paris Club agreement. Thus, arrears on payments to official creditors began to accumulate once the latter expired; in addition, negotiations with commercial banks for refinancing of trade-related debt were also unexpectedly delayed. In the case of Liberia, payments arrears to a group of banks that financed oil imports developed after approval of the stand-by arrangement. These arrears which were subject to negotiation with the banks could not be eliminated because of delays in reaching agreement with commercial banks on the reactivation of an oil financing facility. As for Zambia, the reduction in payments arrears envisaged in the stand-by arrangement did not take place to a large extent because of a decline in export proceeds as copper export prices and volume turned out to be lower than anticipated.

At the outset, it is to be noted that the exogeneity of the factors that cause a deviation from a program does not, in itself, provide a basis for the extension of a waiver. It is rather the temporary nature of those factors or the small magnitude of the deviation that count for purposes of a waiver, because in either of those circumstances, it can be expected that additional policy action will not be necessary and

therefore, new understandings under the arrangement are not required. As explained below, the circumstances of the three cases under review varied significantly in these respects.

Under its stand-by arrangement, Ecuador effected an important adjustment effort and all other performance criteria for the final purchase were observed. At the time the waiver of the performance criterion on arrears was requested, an agreement had been virtually completed with the banks on the refinancing of trade-related arrears and agreement with the Paris Club on a further rescheduling of maturities due since May 31, 1984 also seemed likely in a relatively short period of time. In addition, Ecuador had established an escrow account in regard of payments to official creditors that fell due after the period of the 1983/84 rescheduling agreement lapsed. On this basis, it was expected that the nonobservance of the commitment on arrears would be temporary and this was the basis for the waiver.

As noted above, in the case of Liberia, arrears to a group of banks that financed oil imports developed after the arrangement was negotiated in mid-1982. At the time of approval (September 1982) the scope of the review clause was enlarged to include the issue of arrears. When this review was conducted two months later, arrears had increased further and agreement with the banks on the matter had not been reached; on that occasion, the period for the elimination of arrears was extended by six months. Again, agreement did not take place in this period. Pari passu with this development, there were shortcomings in fiscal policy and the ceiling on domestic financing of the budget for April

1983 could be met only by borrowing from sources that were left outside the ceiling because they traditionally had not lent to the government; however, by June 1983 the ceiling had been exceeded. Lack of agreement with the banks, fiscal slippages and the absence of two purchases from the Fund meant not only that the arrears to the commercial bank group remained, but that arrears on other external debt service payments developed as well. In these circumstances there were no assurances to the effect that the nonobservance of the performance criterion on arrears would be temporary.

As for Zambia, inability to comply with the performance criterion on arrears was only one of the factors that prevented the last purchase from taking place. The drawing was also conditional on a budget review clause which could not be completed because of lack of understandings in this area. Both this lack of understanding on prospective fiscal action and the shortfall in export proceeds provided no grounds for a judgment that the deviation from the performance criterion on arrears was temporary.

The situation with regard to Honduras was somewhat different. First, certain unsettled payments to banks were excluded from the definition of arrears for the purpose of the performance criterion because at the time of negotiation there were firm grounds for believing that a final rescheduling agreement was imminent. Second, the accumulation of the arrears in the case of Honduras was taking place with the implicit consent of banks and it only applied to principal repayments as the country remained current on interest payments throughout the period of the arrangement. Third, Honduras eliminated the arrears

This is unusual?
The program should have been provided for an arrears reduction?

that had been included in the performance criterion on schedule and on the basis of reported data, all remaining quantitative performance criteria were being observed. The issue in this case had to do with the comprehensiveness of the definition of arrears and not with lack of observance of the performance criterion itself. By the time it became clear that the rescheduling was not likely to occur soon, Honduras' performance had gone off-track and drawings had been interrupted. It was also found that data showing observance of other performance criteria in the earlier period of the arrangement had been inaccurate and Honduras was one of the countries reviewed at the Board discussion of reporting problems on performance criteria.

Was a waiver approved?

Attachment

EBS/84/155

CONFIDENTIAL

July 30, 1984

To: Members of the Executive Board
From: The Acting Secretary
Subject: External Payments Arrears of Fund Members, 1982-83

The attached paper reviewing developments in the payments arrears situation of members is circulated for the information of the Executive Directors.

If Executive Directors have technical or factual questions relating to this paper they should contact Mr. Quirk (ext. (5)8520).

Att: (1)

INTERNATIONAL MONETARY FUND

External Payments Arrears of Fund Members, 1982-83

Prepared by the Exchange and Trade
Relations Department

(In consultation with other departments)

Approved by C. David Finch

July 26, 1984

I. Introduction

This paper is the third in a series reviewing developments relating to external payments arrears of Fund members and the implementation of the Fund's policies in assisting members to eliminate this form of exchange restriction. 1/ It presents updated information for 1982 and 1983, and reviews the treatment of payments arrears within stand-by and extended arrangements in effect as of the end of June, 1984 and within the broad context of Fund jurisdiction under Articles VIII and XIV. The paper also discusses the relative emphasis on cash payments and rescheduling of obligations to obtain the targeted arrears reductions. The criteria relating to the elimination and re-emergence of arrears in the context of the use of Fund resources and for purposes of Fund jurisdiction under Articles VIII and XIV are also mentioned.

II. Developments in the Arrears Situation

The previous report on external payments arrears of Fund members (EBS/83/12, 1/12/83) noted a sharp upturn in aggregate arrears of members in 1982, to SDR 22.4 billion, following relatively stable levels (SDR 5-6 billion) in the preceding 5 years. In 1983, the notable feature at the aggregate level was the continuation of a high level of arrears 2/ (SDR 27.1 billion), although the rate of increase was markedly

1/ See also "External Payments Arrears of Fund Members, 1980-81" (EBS/82/57, 3/31/82) and "External Payments Arrears of Fund Members, 1981-82" (EBS/83/12, 1/12/83).

2/ Payments arrears are attributed to a variety of causes; the Fund's data on members' payments arrears comprehends arrears which have been caused by exchange restrictions on current payments or transfers as well as arrears on financial obligations of which the obligor is the government or a resident in the country in question and which are overdue for balance of payments or fiscal reasons. Payments arrears evidence an exchange restriction under Article VIII, Section 2(a) and Article XIV, Section 2 when the authorities of a country are responsible for undue delays in approving

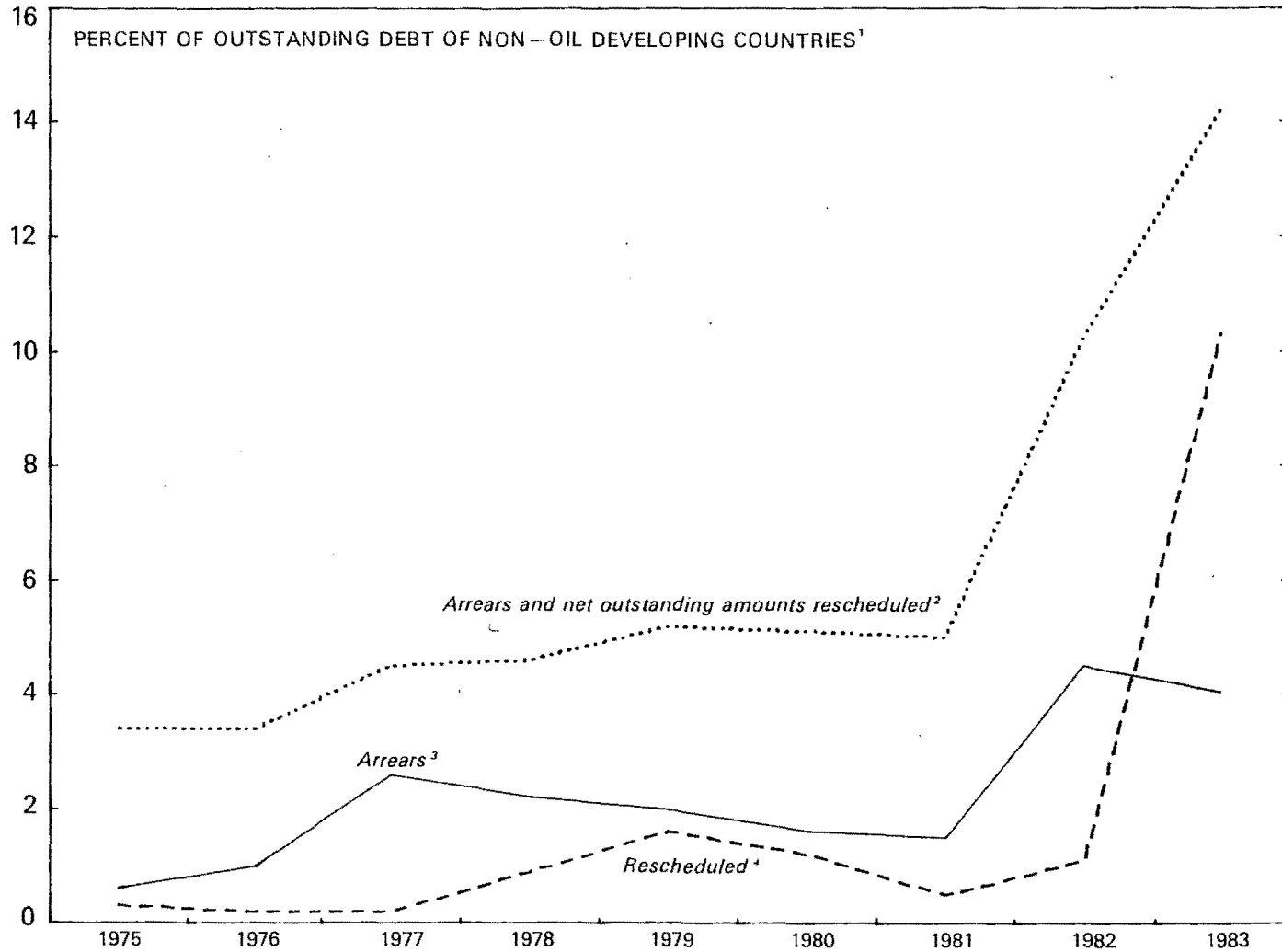
lower than in 1982 (Appendix Table 1). Some two thirds of total arrears at end-1983 were accounted for by three large members (Argentina, SDR 11.6 billion; Brazil, SDR 2.2 billion; 1/ and Nigeria, SDR 5.6 billion). Nevertheless, the number of Fund members incurring payments arrears has been rising steadily in recent years; in 1983 the number rose from 37 to 42. Of the 52 Fund members incurring payments arrears at some point during 1976-83, only 10 had managed to eliminate them by end-1983. Of the other 42 countries, 10 experienced virtually continuously rising arrears in recent years, whereas only 3 countries demonstrated a steady decline. During 1983, payments arrears emerged for the first time since 1976 in Belize, Brazil, Ivory Coast, Paraguay, St. Lucia, the Philippines, and Venezuela. Jamaica eliminated payments arrears in 1982 but incurred new arrears in 1983. Four countries--Central African Republic, Haiti, Romania, and Yugoslavia--eliminated payments arrears or government defaults in 1983, and Brazil eliminated arrears in March 1984. Outstanding payments arrears or government defaults rose in 15 countries in the course of 1983; in one country the outstanding amount remained unchanged. A fuller discussion of developments in individual members' arrears in 1983 (based on information available in the first quarter of 1984) is presented in the Annual Report on Exchange Arrangements and Exchange Restrictions, 1984.

Apart from payments arrears, departures from originally contracted external obligations can also be assessed in terms of the negotiated restructuring of external debt obligations. In this sense the full extent of such departures might be measured by aggregating arrears and outstanding amounts rescheduled net of estimated repayments in respect of rescheduled amounts (the sum of lines (a) and (c) in Appendix Table 2). From this broader perspective, deferrals of external contractual obligations increased sharply in 1983, reflecting the record level of rescheduling (SDR 67.6 billion, as compared with SDR 5.5 billion in 1982). As of the end of 1983, the combined total of arrears and outstanding rescheduled payments obligations amounted to 14 percent of non-oil developing countries' debt, up from 10 percent at end-1982, and 5 percent at end-1981 (Chart 1). This

2/ Cont'd from p. 1) applications or in meeting bona fide requests for foreign exchange for current international transactions, as defined in Article XXX (d). When a government or a government entity whose financial operations form part of the budgetary process fails to meet an external payments obligation due to a lack of domestic currency, the resulting arrears are considered to be defaults rather than payments arrears that evidence exchange restrictions. Similarly, payments arrears incurred by governments participating in a common central bank are treated as defaults when they are due to the government's inability to obtain domestic currency with which to purchase needed foreign exchange from the common central bank. Although the above distinction is relevant for the purposes of Articles VIII and XIV, in the context of the Fund's policies on the use of its resources, defaults and other forms of arrears involving current and capital payments are viewed as having the same broad macroeconomic character and consequences, and are therefore treated in the same manner.

1/ Brazil's arrears outstanding at the end of 1983 reflected delays in the completion of foreign commercial bank debt rescheduling.

CHART 1
 PAYMENTS DELAYED AND DEFERRED BY FUND MEMBERS 1975-1983



Source: World Bank, World Debt Tables 1983-84; OECD, External Debt of Developing Countries, 1984; IMF *International Financial Statistics* (various issues); and staff estimates.

¹Public and publicly-guaranteed debt.

²Sum of arrears and outstanding rescheduled amounts, net of estimated payments in respect of rescheduled amounts (stocks as of end of the indicated year), as percent of total outstanding debt.

³From Appendix Table 1.

⁴Amounts rescheduled in each year (flows) are with respect to ODA countries and major private creditors (See Appendix Table 2).

increase may be in part transitional, as liquidation of large arrears by some members are presently under discussion, and the volume of rescheduling operations in 1984 may not be as high as in 1983. Past experience suggests, however, that, once in place, arrears are difficult to reverse on a sustained basis. Also the overall maturity structure of developing countries' debt and the concentration of scheduled payments in the years 1985-87 suggest the possibility that widespread deferrals may recur. 1/

The maintenance of payments arrears and the ensuing disorderliness in financial flows creates serious difficulties for debtor countries and is of substantial concern to foreign creditors. However, the accumulation of arrears is generally a late symptom of major balance of payments disequilibria. In other words, by the time external arrears emerge, the country's external sector has in most cases been already under strain for some time. With the emergence of arrears, problems of external adjustment frequently intensify because the customary channels of external financing are disrupted. Hence, the prompt elimination of external payments arrears in the course of a stabilization program would benefit the country through the reconstitution of financing streams, thereby facilitating the growth of domestic income and output.

Detailed information concerning the type of balance of payments operation related to payments arrears since 1980 is available for some two thirds of countries with arrears in this period; the staff is continuing its efforts to ensure accurate and comprehensive information in this area (Appendix Table 3). Arrears relating to payments for international trade in goods and services constituted about one half of total arrears (excluding those for Argentina) in 1981-83 for which the corresponding balance of payments categories are identified. The emergence of this form of arrears has eroded the normal short-term financing mechanisms and has contributed to the growing use of bilateral financing arrangements, including barter and countertrade. It has also proved difficult to organize satisfactory arrangements for the negotiated rescheduling of these arrears, given their short-term character and the large number and often heterogenous nature of creditors involved.

III. Implementation of Fund Policies in Programs in Support of Use of Resources

1. Performance criteria

In accordance with the policies set out in Executive Board Decision No. 3153-(70/95) the Fund, in approving requests for the use of its resources, requires not only that new external payments arrears be avoided

1/ Insofar as a "second round" of restructuring would directly or indirectly involve previously rescheduled debt, it would not add to the deferral ratios. Recurrent rescheduling would, of course, make it more difficult to provide meaningful estimates of these ratios and thus the extent of departures from governing contractual terms.

but also that existing arrears be eliminated, or at least reduced, within the program period. In formulating the coverage of targets for arrears reduction the staff is guided not only by the criteria of the Articles of Agreement but also by economic and financial considerations in the context of the program. Hence, external payments arrears in this context include those defined as such for the purpose of Fund jurisdiction under Article VIII, as well as all other overdue external financial obligations, such as payments arrears in respect of medium and long-term capital transfers and nonpayments by the member classified as defaults. Among those members that had a stand-by or extended arrangement in effect with the Fund as of June 30, 1984, 17 countries maintained external payments arrears at the time that the respective program had been approved (Appendix Table 4): Brazil, 1/ Dominican Republic, Ecuador, The Gambia, Ghana, Guatemala, Ivory Coast, Jamaica, Liberia, Madagascar, Mali, Mexico, Sierra Leone, Sudan, Togo, Uganda, and Zaïre. Arrangements involving all but three (Madagascar, Sudan, and Togo) of the 17 countries included as a specific performance criterion the reduction or elimination of outstanding payments arrears during, or by the end of, the program period in accordance with a quantitative schedule. 2/ The stand-by arrangement for Madagascar contained an intention by the authorities to reduce external payments arrears during the second half of 1984, and purchases under the arrangement after midyear were made contingent on the reaching of understandings with the Fund on a set of performance criteria, including provision for the reduction of external arrears. In the case of Sudan, the precarious external position of the country and the prospect of continued balance of payments weakness in the medium term were important factors in the decision not to include a performance clause on reduction of external arrears. Nevertheless, purchases were made contingent on the completion of a debt rescheduling operation, including the consolidation of arrears on debt service payments. Togo's outstanding external arrears as of the end of 1983 (when the program was formulated) were about SDR 1 million, corresponding to a residual amount owed to a country that did not take part in the 1983 rescheduling of Togo's overdue external obligations; this small sum was consolidated in early 1984. 3/ In another case (Sierra Leone) outstanding arrears were to be reduced through a small amount of cash payments, to signal primarily the authorities' commitment to financial discipline. A significant proportion of outstanding arrears was expected at the time of the negotiations to be consolidated as part of a multilateral debt rescheduling operation, which was a prior condition.

1/ In Brazil, external payments arrears were identified after the extended arrangement was approved by the Executive Board; elimination of the arrears became a performance criterion at the time the Executive Board approved Brazil's request for a waiver and modification of performance criteria (Decision No. 7562-(83/160), adopted November 22, 1983).

2/ The one-year stand-by arrangement with Western Samoa which expired on June 26, 1984 also included a specific performance clause on the reduction of external payments arrears.

3/ The program with Togo contains as a performance criterion the reduction of domestic arrears by the Central Government.

A problem sometimes encountered is that the level of arrears at the start of the program cannot be determined with certainty. On some occasions, the level initially considered as correct has overstated the true level (e.g., Dominican Republic), and in others there was an under-estimation (e.g., Ecuador, Uganda). In the latter type of situation there may be problems relating to the adequacy of the overall adjustment program if large amounts of arrears are identified only after the program has been designed. In addition, there is the technical question of how to treat such cases in the context of performance tests for arrears. In dealing with such cases, the performance criterion for arrears reduction is generally expressed in terms of a flow for the purpose of monitoring compliance with the performance criteria under the program. In other words, regardless of the initial level of arrears, compliance with the schedule to reduce such arrears means that arrears should be reduced in nominal terms by at least the amount included in the authorities' statements or supporting documents submitted to the Executive Board. This is necessary to ensure the internal consistency of the program targets for the external sector and for domestic financial policies. The only exception would be cases in which, ex post, the actual initial stock of arrears is subsequently found to be smaller than the programmed reduction over the agreed period.

A recent staff paper, "The Role of the Fund in the Settlement of Disputes Between Members Relating to External Financial Obligations" (SM/84/89, 4/25/84) discussed the point in rescheduling negotiations at which arrears are considered to have been eliminated as well as the circumstances in which arrears are again considered as arrears for the purpose of the target on arrears reduction:

...the Fund's approach under its arrangements has been to regard the multilateral Agreed Minutes of the Paris Club as a satisfactory basis for treating the requirement of associated debt relief as having been met and, therefore, for purposes associated with the financial aspects of the adjustment program, to treat the associated payments arrears as having been eliminated....Since the Paris Club now stipulates a final date for concluding the bilateral agreements, the Fund would normally regard the failure to conclude the bilateral agreements by that date as entailing payments arrears. However, a reporting procedure could be devised so that the debtor's right to make further purchases under an arrangement would not be interrupted in the event that the delay in reaching an agreement occurred despite exercise of the debtor's best efforts.

The paper also noted that "For purposes of Fund jurisdiction under Articles VIII and XIV, however, the restriction entailed in the payments arrears continues until eliminated pursuant to formal agreement between the interested parties"--i.e., upon completion of the bilateral Paris Club signings or the drawing up of new individual contracts for bank debt. The

continuation of an Article VIII restriction would not, however, preclude notification to the Executive Board in the event of a member's failure to conclude satisfactorily the drawing up of the bilateral contracts.

2. Rescheduling vs. cash payments

At the time of approval by the Board of an arrangement with the Fund, it is necessary for there to be sufficient assurance that the projected capital flows will be available. The intention of this requirement is to ensure the realism of external financing assumptions of adjustment programs, including the attainability of the targeted reductions in outstanding arrears. In order to meet this requirement several arrangements have incorporated, either implicitly or explicitly, the assumption that the member enter into agreements with creditors to consolidate existing payments arrears and to reschedule maturing debt service obligations. In six arrangements in effect as of June 30, 1984, an undertaking by the country to reschedule all or part of its external payments arrears was included either as a prior condition for the arrangement to become effective (Ivory Coast, Madagascar, Sierra Leone, Sudan, and Zaire) or as an explicit intention on the part of the authorities (Uganda). In most of these cases the authorities had already initiated, or were planning to initiate, contacts with creditors to reschedule external arrears. In the case of Brazil, where at the time of the initial program negotiation external payments arrears were not identified, subsequent modifications of the program in this regard were predicated on agreements among creditors. Mexico had concluded in principle negotiations with its creditors on the consolidation of arrears on the servicing of the public debt by the time the extended arrangement was approved. In all of the cases in which rescheduling of outstanding arrears was an objective of the program, the schedule for the elimination/reduction of arrears was formulated taking into account the timing as well as the magnitude of the expected rescheduling. On occasions when the timetable for the expected rescheduling was not known with sufficient precision, the performance criteria related to the arrears were specified in such a way as to avoid to the extent possible interruption of the members' right to request a purchase under the arrangement solely as a result of a change of the timetable.

As to the speed at which arrears were to be reduced, elimination of outstanding amounts by or before the end of the program period was specified in the stand-by arrangements with Ecuador, Ivory Coast, Jamaica, Liberia, and Mali and in the multi-year arrangements with Brazil and the Dominican Republic. In the cases of Brazil and Ecuador, explicit provision was made for the elimination of arrears before the end of the arrangement. In the arrangements with three members (Mexico, Uganda, and Zaire) no specific target for the reduction of payments arrears during the entire arrangement was included, but a target for the first year of the extended arrangement (or for a specified number of months within the period of a stand-by arrangement) was established, and there were understandings that subjected future purchases to targets for reductions of arrears. The partial elimination of external arrears in the first year of multi-year arrangements was contemplated in the arrangements with Mexico and the Dominican Republic. In

only one case (Dominican Republic) was a reduction in outstanding arrears specified for the first year at the same time that elimination was specified for the entire period of the arrangement. In the case of Mexico, purchases under the arrangement after the first year were made subject to the reaching of understanding with the Fund on the setting of a schedule for the elimination of any remaining external arrears.

In the case of some arrangements the target for arrears reduction was formulated at least partly in terms of cash payments. This specification was included in seven of the arrangements in effect as of June 30, 1984 ^{1/} (The Gambia, Ghana, Guatemala, Jamaica, Sierra Leone, Uganda, and Zaïre). In the instances of The Gambia, Ghana, Guatemala, Sierra Leone, Uganda, and Zaïre, the programs stipulated that arrears would be reduced solely by cash payments. In the program with Jamaica, the performance criterion included the reduction of arrears by both cash payments and consolidation; cash payments represented some 13 percent of the total amount of arrears to be eliminated.

The provision that a certain minimum amount of arrears reduction be in the form of cash payments has on a number of occasions contributed to ensure the consistency of program targets. Where the rescheduling of arrears realized in the Paris Club or in other fora exceeded the minimum assumed in formulating the program, a global target that did not distinguish between rescheduling or cash payments against arrears could lead to a higher than programmed volume of net foreign financing, with consequences for other external targets and domestic monetary targets. Of course, an excessively liquid short-term foreign exchange position may also result when actual rescheduling terms are more generous than anticipated, even in the presence of a criterion specifying minimum cash payments. In some instances in the past, additional financing so made available has been used for the repayment of other outstanding arrears, or existing obligations not yet due.

3. Outcome under program targets

Out of 15 arrangements in effect as of the end of November 1982 with countries maintaining payments arrears at the time those programs were introduced, ^{2/} the performance criterion related to the elimination/reduction of external payments arrears was not fully met throughout the program period in seven of the arrangements (Costa Rica, El Salvador, Honduras, Jamaica, Madagascar, Somalia, and Togo). In two of these arrangements, the members were able to return to compliance with the performance criterion before the

^{1/} In the stand-by program with Western Samoa that expired on June 26, 1984 the target for arrears reduction was formulated in terms of cash payments.

^{2/} Costa Rica, El Salvador, The Gambia, Haiti, Honduras, Jamaica, Liberia, Madagascar, Mali, Romania, Senegal, Somalia, Togo, Turkey, and Uganda. This is the sample of programs analyzed in "External Payments Arrears of Fund Members, 1981-82" (EBS/83/12, 1/12/83). Although there were 16 countries included in the review, the program with Sudan did not include a performance criterion on the reduction of arrears.

end of the program. In the case of El Salvador, the commitment to reduce external arrears was not complied with during the first half of the program; shortly afterward purchases were interrupted because the mandatory, mid-term review was not completed on time. Subsequently, however, the authorities reduced outstanding arrears and the country's right to purchase under the program was restored. In the case of Somalia, arrears outstanding at the time the program was negotiated were eliminated before the Executive Board approved the arrangement, but new arrears emerged later on, thus triggering the standard performance clause regarding the introduction of exchange restrictions subject to Fund jurisdiction. Somalia was granted a waiver and shortly afterward the new arrears were eliminated. Two other members (Jamaica and Madagascar) did not comply with the performance criterion relating to the reduction of arrears and were granted waivers in connection with the performance criterion on arrears.

In four of the seven arrangements under review (Costa Rica, Jamaica, Madagascar, and Togo) the level of arrears was considerably higher at the end of the respective programs than at the time these programs were negotiated. All of the four countries were characterized by considerable external maladjustments and were involved in major debt rescheduling negotiations. The arrangement with Honduras, which included a commitment by the authorities to eliminate external arrears on current payments during the first months of the program, ran into difficulties with respect to the arrears target during the last few months of the program. By that time the country's foreign exchange position had deteriorated and the authorities started to accumulate new arrears. Having breached more than one performance criterion, Honduras did not make its last purchase under the arrangement.

IV. Approvals Under Article VIII of the Articles of Agreement

The approval status of external payments arrears maintained by Fund members since January 1983 is summarized in Appendix Table 5. The existence of payments arrears as an exchange restriction was noted in all of the staff reports for the relevant Article IV consultations or the staff papers on requests for the use of Fund resources. In the Executive Board decisions relating to the maintenance of payments arrears as an exchange restriction, approval was granted in 15 cases during the period under review, all of which on a temporary basis. In all of these cases, the member had a stand-by or an extended arrangement in effect, and in 14 of them approval was granted because the financial program contained an undertaking to reduce or eliminate payments arrears. ^{1/} In the other case in which approval was granted, the

^{1/} In the case of Peru, general agreement on the restructuring of debt service obligations had been reached with Paris Club and commercial bank creditors at the time the Executive Board considered Peru's request for a stand-by arrangement in April 1984; for purposes of Fund jurisdiction under Article VIII, approval was granted for the maintenance of arrears until completion of respective bilateral agreements.

stand-by program of Sudan (approved in principle on January 28, 1983 and effective as of February 23, 1983) did not contain a specific undertaking with respect to a reduction of outstanding external payments arrears. It allowed an accumulation of external payments arrears with respect to debt service obligations to those creditors with whom debt relief arrangements were made but where implementation agreements were not yet finalized at the time. In two other instances where a stand-by or an extended arrangement was in effect (Honduras, November 1983; Guatemala, June 1984), approval was not granted. In the case of Honduras, approval was not granted because certain performance clauses under the stand-by arrangement were not being observed, including that relating to payments arrears. In the case of Guatemala, even though arrears had been reduced as scheduled during the first part of the program, the authorities failed to reach understanding with the Fund on the setting of performance criteria for the remainder of the arrangement.

In 15 other cases, where the payments arrears were recognized as constituting an exchange restriction subject to Article VIII, approval was not proposed by the staff because there was no meaningful program to reduce the level of payments arrears or the programmed reduction was considered inadequate. A substantial reduction in the level of payments arrears has therefore been a prerequisite for approval by the Executive Board under Article VIII of the Fund's Articles. Since January 1983, in no instance has the Fund approved exchange restrictions resulting in payments arrears in the context of stand-by or extended arrangements when purchases under the arrangement could not be resumed because of nonobservance of a performance criterion, including that relating to payments arrears. 1/

1/ This policy was also consistently followed during 1981-82, as noted in EBS/83/12, p. 13.

Table 1. External Payments Arrears Outstanding, 1976-1983 1/

(In millions of SDRs; end of period)

	1976	1977	1978	1979	1980	1981	1982 2/	1983 2/	1983 arrears as percentage of	
									1982 imports 3/	Level of gross official international reserves 4/
Antigua and Barbuda	--	--	--	1	2	3	8	15	12.1	63.2 8/
Argentina*	--	--	--	--	--	--	7,269	10/11/11,578	10/11/227.1	758.1
Belize	--	--	--	--	--	--	--	2	1.6	31.5
Benin	...	--	--	22	21	18	...	...	...	...
Bolivia	--	--	--	12	126	10/ 111	10/ 258	10/ 415	92.1	318.5 8/
Brazil*	--	--	--	--	--	--	--	2,235	11.7	53.8 8/
Central African Republic*	35	39	8	42	63	6	13	--	--	--
Chad	9	9	5	4	3	2	2	4	4.1	36.5 7/
Congo	4	4	23	31	8	5	3	3	0.4	8.9 7/
Costa Rica	--	--	--	--	222	552	993	30	4.1	10.1 8/
Dominican Republic*	11	--	--	17	37	54	165	75	5.3 8/	63.2
Ecuador*	--	--	--	--	--	--	191	102	7.3 8/	23.7
Egypt	312	862	--	--	--	--	--	--	--	--
El Salvador	--	--	--	--	32	56	55	31	3.8	28.9
Gabon	--	430	339	--	--	--	--	--	--	--
The Gambia	--	--	--	--	9	20	12	43	53.1	2,375.0
Ghana*	192	201	393	324	269	434	535	504	78.9	359.0 9/
Grenada*	x	x	2	1	--	--	--	1	1.8 8/	8.4 9/
Guatemala*	--	--	--	--	--	--	--	274	25.1 8/	106.6
Guinea	90	119	151	150	82	122	160	192	43.0	125.0
Guinea-Bissau	7	7	8	5	7	15	27	--	...	...
Guyana	--	27	17	22	29	71	189	288	113.3	8,228.0
Haiti*	--	--	--	--	--	17	22	--	--	--
Honduras*	--	--	--	--	--	11	44	55 12/	8.6	48.3 9/
Ivory Coast	--	--	--	--	--	--	--	163	8.4	866.5 8/
Jamaica*	--	22	48	42	89	39	--	86	10.4 8/	142.5 8/
Liberia*	--	--	--	--	--	6	42	33	8.0 6/	783.0 9/
Madagascar	5	7	11	13	175	103	116	149	40.6 6/	647.5 9/
Mali*	--	11	18	27	38	51	20	12	4.0	65.9
Mauritania	x	9	23	15	39	21	39	67	27.5	67.5
Mexico*	--	--	--	--	--	--	2,971	267	3.9	7.1 8/
Nicaragua	--	--	58	363	188	50	145	195	27.7	125.6 7/
Nigeria	--	--	--	--	--	--	3,672	5,629	32.3 6/	595.3 8/
Paraguay	--	--	--	--	--	--	--	146	24.3 8/	22.4 8/
Peru*	...	...	115	--	--	--	--	--	--	--
Philippines*	--	--	--	--	--	--	--	1,544 10/	25.9 8/	202.0
Romania*	--	--	--	--	--	981	352	--	--	--
St. Lucia	--	--	--	--	--	--	--	x	--	--
Senegal*	--	--	--	--	7	12	--	--	--	--
Sierra Leone	4	15	25 13/	39 13/	55 13/	113 13/	200 13/	264	97.4	1,227.9
Somalia*	--	--	--	--	13	35	13	--	--	--
Sudan*	241	572	597	878	1,081	1,505	1,575	250	29.5	1,428.5 9/
Tanzania	4	2	55	126	254	294	350	400	39.9	2,023.2 8/
Togo*	--	8	34	21	25	80	162	1	0.28	0.60 8/
Turkey*	202	1,710	1,523	1,769	1,266	275	--	--	--	--
Uganda*	29	21	63	68	172	130	113	75	273.0	569.5 5/
Venezuela	--	--	--	--	--	--	--	460	4.6 8/	6.5
Viet Nam 15/	--	--	--	--	--	33	228	408	30.0	891.7
Western Samoa*	--	--	--	--	1	9	13	3	5.8 8/	54.1 9/
Yugoslavia*	--	--	--	--	--	--	325	--	--	--
Zaire*	385	671	950	1,118	450	530	848	372	85.8	328.5 7/
Zambia*	223	394	496	351	461	500	947	720	79.5	1,383.5 8/
Total	1,753	5,140	4,962	5,474	5,246	6,278	22,366	27,134	--	--
Memorandum item:										
Aggregate amount resched-										
uled in each year 14/	334	457	2,222	4,462	3,769	1,893	5,525	67,585		

Sources: Country authorities; and staff estimates.

1/ The Table shows data on countries known to have had external payments arrears in any year during the period 1976-1983 or other dates indicated in the footnotes. Defaults, i.e., payments arrears incurred by governments participating in common central bank arrangements (Bank of Central African States (BEAC), Central Bank of West African States (BCEAO), and Eastern Caribbean Central Bank (ECCB)) resulting from the government's inability to obtain domestic currency with which to purchase needed foreign exchange from the common central bank, as well as those incurred by the government or a government entity whose financial operations form part of the budgetary process, are included in these figures. In the former case, since it is not possible to distinguish between domestic and external arrears, total arrears are shown. Overdue financial obligations to the Fund are excluded from the table.

2/ Latest estimates available in 1982 and 1983; where end-year data are not available, data at the end of the most recent period are used to arrive at totals. Totals for ratios to imports and reserves are unweighted averages.

3/ Figures are from IFS (imports, c.i.f.) and refer to end of period-1982, unless specified otherwise. Totals for ratios to imports are unweighted averages.

4/ Figures are from IFS (total reserves minus gold) and refer to end-February 1984, unless specified otherwise.

Totals for ratios to reserves are unweighted averages.

5/ End-1980

6/ End-1981

7/ End-1982

8/ End-1983

9/ End-January 1984

10/ Includes payments arrears postponed in agreement with commercial banks, but not yet rescheduled.

11/ It includes staff estimates of principal owed to banks that would have been subject to rescheduling under the terms of the draft principles agreed by banks in December 1982.

12/ Includes past due principal owed to foreign commercial banks which is under negotiation for rescheduling.

13/ Based on end-June fiscal year.

14/ Amounts are with respect to ODA countries and major private creditors and include rescheduling of arrears and of obligations not yet due.

15/ Includes imputed interest of arrears.

Symbols: * Financial program supported by use of Fund resources in effect in December 1983 (including arrangements under which purchases have been suspended). x Arrears less than SDR 0.5 million.

Table 2. Payments Delayed and Deferred by Non-Oil Developing Countries, in Relation to Imports and Debt, 1975-83 ^{1/}

	1975	1976	1977	1978	1979	1980	1981	1982	1983
(In millions of U.S. dollars)									
a. Arrears	990	2,037	6,244	6,464	7,211	6,691	7,307	24,675	28,408
b. Rescheduling ^{2/}	458	386	534	2,782	5,765	4,905	2,232	6,100	72,249
c. Cumulative net amounts due and rescheduled ^{3/}	4,494	4,550	4,596	7,145	11,324	14,352	16,712	31,097 ^{4/}	72,585
d. Imports of non-oil developing countries	162,570	172,787	207,277	244,990	314,252	412,290	432,061	457,990	388,494
e. Outstanding public and publicly-guaranteed debt of non-oil developing countries	160,111	192,239	239,283	298,674	353,078	408,741	477,155	550,637	702,068

Sources: IBRD, World Debt Tables; OECD, External Debt of Developing Countries; IMF, IFS; and staff estimates.

^{1/} Including Indonesia and Nigeria

^{2/} Amounts rescheduled in each year are with respect to ODA countries and major private creditors.

^{3/} Outstanding amounts rescheduled, net of estimated payments in respect of rescheduled amounts.

^{4/} Includes Mexican public sector and nationalized bank debt subject to 90-day rollover from August 23, 1982 (extended by 120 days).

Table 3. External Payments Arrears, by Type of Payments, 1981-83

(In millions of U.S. dollars) 1/

	1981				1982				1983			
	Import payments	Invisible payments 2/	External debt service payments		Import payments	Invisible payments 2/	External debt service payments		Import payments	Invisible payments 2/	External debt service payments	
			Interest	Capital			Interest	Capital			Interest	Capital
Argentina	--	--	--	--	1,159	384	837	5,639 3/	1,651	476	987	9,008 3/
Benin	--	--	4	17	...	...	...	...	...	...	...	...
Bolivia	--	--	20	110	--	--	119	188	--	--	103	359
Central African Rep.	--	--	2	5	--	--	3	11	--	--	--	--
Congo	--	--	--	6	--	--	--	3	...	...	...	...
Costa Rica	282	--	148	212	423	--	302	370	--	--	15	17
El Salvador	44	--	--	21	44	--	7	9	--	--	2	2
The Gambia	19	4	--	--	11	2	--	--	36	...	5	2
Ghana	278	172	15	40	348	183	12	47	...	...	...	...
Guatemala	--	--	--	--	197	32	57	2	200	86	--	--
Guinea	--	--	31	111	...	...	37	139	...	...	44	157
Guyana	83 4/	...	--	--	183	--	12	12	...	...	...	...
Haiti	13 4/	...	--	7	21	--	--	3	--	--	--	--
Honduras	--	--	--	13	--	--	2	49	10	--	10	38
Jamaica	30	6	9 5/	...	--	--	--	--	...	...	...	...
Mali	19	17	22	1	11	6	1	2	7	3	1	--
Mauritania	--	--	11 5/	13	--	--	7	18	...	...	...	...
Nicaragua	--	--	21	37	...	...	...	...	...	...	...	...
Romania	571	68	502 5/	...	...	...	...	...	--	--	--	--
Senegal	--	...	14 3/	...	--	--	--	--	--	--	--	--
Sierra Leone	114 4/	...	3	14	159 4/	...	13	46	200	...	21	54
Somalia	--	--	3	12	--	--	--	--	--	--	--	--
Sudan	613	--	280	859	243	--	206	1,288	209	--	49	4
Tanzania	294 4/	...	--	48	340 4/	...	--	46	...	...	...	...
Togo	--	--	19	74	--	--	38	141	...	...	...	...
Turkey	320 4/	--	--	--	--	--	--	--	--	--	--	--
Uganda	21 4/	...	130 5/	...	18 4/	...	108 5/	...	...	...	...	...
Viet Nam 6/	--	--	5	33	--	--	44	207	--	--	92	336
Western Samoa	9	...	...	2	9	...	...	5	--	...	...	3
Zaire	453	33	74	97	209	19	281	426	175	16	122	76
Zambia	308	274	--	--	397	491	52	105	...	...	...	...

Sources: Country authorities; and staff estimates.

1/ Table does not show data on all countries appearing in Table 1, because data on some countries do not exist or are reliable.

2/ Excludes interest payments on external debt.

3/ Includes staff estimates of principal owed to banks that would have been subject to rescheduling under the terms of the draft principles agreed by banks in December 1982.

4/ Includes invisible payments (excluding interest payments on external debt).

5/ Includes principal.

6/ Includes imputed interest of arrears.

Table 4. Treatment of Payments Arrears Under Stand-by or EFF Arrangements in Effect as of June 30, 1984 ^{1/}

Country	Type of arrangement, effective date, amount, per cent of quota	Total amount of payments arrears outstanding at time of program formulation (SDR million)	Limit on payments arrears specified ^{2/}		Elimination/reduction of payments arrears as performance criterion ^{3/}		Targeted amt. of payments arrears reduction	
			During program period	First year of program period	During program period	First year of program period	During program period	First year of program period
Brazil	EFF, 2/28/83 SDR 4,239.375 m. 450 percent	2,426	--	--	--	yes(E)	--	2,426
Dominican Republic	EFF, 1/21/83 SDR 371.5 m. 450 percent	412	--	--	yes(E)	yes(R)	412	96
Ecuador	1 yr. SB, 7/25/83 SDR 157.5 m. 150 percent	535 ^{10/}	--	--	yes(E)	--	535	--
Gambia	15 mths. SB, 4/23/84 SDR 12.83 m. 75 percent	43 ^{11/}	--	--	yes(R)	--	5 ^{12/}	--
Ghana	1 yr. SB, 8/3/83 SDR 238.5 m. 150 percent	573	--	--	yes(R)	--	93 ^{13/}	--
Guatemala	16 mths. SB, 8/31/83 SDR 114.75 m. 150 percent	382	yes	--	yes(R)	--	144	--
Ivory Coast	1 yr. SB, Approved in principle SDR 82.75 m. 50 percent	124	yes	--	yes(E)	--	124 ^{14/}	--
Jamaica	1 yr. SB, 6/22/84 SDR 64 m. 44 percent	393 ^{15/}	yes	--	yes(E)	--	393	--
Liberia	1 yr. SB, 9/14/83 SDR 55 m. 99 percent	13 ^{16/}	yes	--	yes(E)	--	13	--
Madagascar	15 mths. SB, 4/10/84 SDR 33 m. 65 percent	149	yes	--	no	--	-- ^{17/}	--
Mali	18 mths. SB, 12/9/83 SDR 40.5 m. 100 percent	19	yes	--	yes(E)	--	19 ^{18/}	--
Mexico	EFF, 1/1/83 SDR 3,410.65 m. 450 percent	1,239 ^{19/}	--	yes	no ^{20/}	yes(R)	--	544
Sierra Leone	1 yr. SB, 2/3/84 SDR 50.2 m. 86.7 percent	259	yes	--	yes(R)	--	1	--
Sudan	1 yr. SB, 6/25/84 SDR 90 m. 53 percent	250	yes ^{21/}	--	no	--	--	--
Togo	1 yr. SB, 5/7/84 SDR 19 m. 49.5 percent	1	yes	--	no	--	--	--
Uganda	1 yr. SB, 9/16/83 SDR 95 m. 126.7 percent	54	--	--	yes(R)	--	19	--
Zaire	15 mths. SB, 12/27/83 SDRs 228 m. 100 percent	372 ^{22/}	yes	--	yes(R)	--	50 ^{13/}	--

Table 4. (concluded) Treatment of Payments Arrears under Stand-by or EFF Arrangements in Effect as of June 30, 1984 ^{1/}

Country	Ratio of targeted payments arrears reduction to total arrears		Ratio of targeted payments arrears reduction to drawing		Re-scheduling of arrears as pre-condition or objective ^{6/}	Net cash reduction of arrears as separate performance criterion	Drawing interrupted due to non-observance of performance criterion on arrears ^{7/}	Counterpart deposit requirement ^{8/}	Approval status ^{9/}
	During program period (In percent)	First year period	During program period ^{4/}	First year period ^{5/}					
Brazil	--	100	--	195	no	no	no	no	yes(T)
Dominican Republic	100	23	111	78	no	no	no	yes	yes(T)
Ecuador	100	--	340	--	no	no	no	no	yes(T)
Gambia	11	--	38	--	no	yes	no	yes	yes(T)
Ghana	16	--	39	--	no	yes	no	no	yes(T)
Guatemala	38	--	125	--	no	yes	yes	yes	yes(T) ^{23/}
Ivory Coast	100	--	150	--	yes(P)	no	no	no	no ^{24/}
Jamaica	100	--	614	--	no	yes	no	yes	yes(T)
Liberia	100	--	24	--	no	no	no	no	yes(T)
Madagascar	--	--	--	--	yes(P)	no	no	no	no ^{24/}
Mali	100	--	47	--	no	no	no	no	no ^{24/}
Mexico	--	44	--	57	no	no	no	yes	yes(T)
Sierra Leone	0.4	--	2	--	yes(P)	yes	no	yes	yes(T)
Sudan	...	...	...	...	yes(P)	no	...	no	yes(T)
Togo	--	--	--	--	no	no	no	no	no ^{24/}
Uganda	35	--	20	--	yes(O)	yes	no	no	yes(T)
Zaire	13	--	22	--	yes(P)	yes	no	no	yes(T)

Source: Executive Board papers dealing with use of Fund resources.

^{1/} Includes arrangements under which purchases have been suspended.

^{2/} The standard clause on introduction and intensification of exchange restrictions also applies to the incurrence of new payments arrears. The answer to the question therefore indicates only cases where a limit (i.e., freeze) on outstanding payments arrears is specifically provided for in the program.

^{3/} Yes (E), elimination; Yes (R), reduction.

^{4/} Ratio of payments arrears reduction specified for the program period to total amount of arrangement.

^{5/} Ratio of payments arrears reduction during the first year of program period to drawings during the first year of program period unless otherwise stated.

^{6/} Yes (P), precondition; Yes (O), objective only.

^{7/} Yes (W), waiver; Yes (M), modification.

^{8/} One hundred percent unless otherwise indicated.

^{9/} Yes (T), temporary approval.

^{10/} Letter of intent indicates that, no later than November 30, 1983, external payments arrears shall be fully paid off.

^{11/} Arrears includes overdue payments owed to the West African Clearing House.

^{12/} Arrears are to be reduced by SDR 1.35 million through cash payments by end of June 1984.

^{13/} Through cash payments only.

^{14/} This figure assumes that Ivory Coast will not receive a short-term loan for prefinancing coffee and cocoa exports.

^{15/} This amount includes SDR 53 million of private sector arrears which will be eliminated through cash payments only.

^{16/} Excluding the oil facility which refinancing was requested on London Club terms.

^{17/} Due to the delay in holding the first program review before end-March 1984 performance criteria, excluding those on payments arrears were, set only through the first half of 1984.

^{18/} This amount includes SDR 7.6 million of arrears of Air Mali. They will be reduced during the program period pending reorganization of the company.

^{19/} This amount was known to have existed subsequent to the negotiation of the program. It includes non-payment of debt which was not treated as payments arrears under the program.

^{20/} Elimination was subject to review by end of first year of program.

^{21/} No arrears will be incurred once rescheduling with creditors has been concluded.

^{22/} As of end of December, 1983; excluding SDR 525 million of arrears consolidated through Paris Club negotiations.

^{23/} The maintenance of external payments arrears was not approved at the conclusion of the 1984 Article IV consultation in June 1984.

^{24/} Payments arrears considered as defaults not exchange restrictions.

Table 5. Treatment of Payments Arrears in Executive Board Decisions, January 1, 1983-June 30, 1984 ^{1/}

	Year of Executive Board Consideration of exchange system	Recognition of payments arrears as exchange restriction	Fund approval at time of Executive Board consideration ^{2/}
Antigua and Barbuda ^{3/}	1984	No	--
Argentina ^{3/}	1983	Yes	Yes
Belize ^{3/}	1984 ^{4/}	No ^{5/}	--
Benin	1983	No ^{5/}	--
Bolivia ^{3/}	1982	Yes	No
Brazil	1983	Yes ^{6/}	Yes
Chad	1984	No ^{5/}	--
Congo, People's Republic	1982	No ^{5/}	--
Costa Rica ^{3/}	1983	Yes	Yes
Dominican Republic ^{3/}	1983	Yes	Yes
Ecuador	1984	Yes	Yes
El Salvador ^{3/ 7/}	1983	Yes	No
Gambia	1983	Yes	No
Ghana	1983	Yes	Yes
Grenada	1983	No ^{5/}	--
Guatemala ^{3/ 8/}	1984	Yes	No
Guinea	1983	Yes	No
Guinea-Bissau	1983	Yes	No
Guyana ^{3/}	1983	Yes	No
Honduras ^{3/}	1983	Yes	No
Ivory Coast	1984	No ^{5/}	--
Jamaica ^{3/}	1983	Yes	Yes
Liberia	1984	No ^{5/}	--
Madagascar	1983	Yes	Yes
Mali	1983	No ^{5/}	--
Mauritania	1983	Yes	No
Mexico ^{3/}	1984	Yes	Yes
Nicaragua ^{3/}	1984	Yes	No
Nigeria	1984	Yes	No
Paraguay	1984	Yes	No
Peru ^{9/}	1984	Yes	Yes
Philippines	1984	Yes	No
St. Lucia ^{3/}	1984	No ^{5/}	--
Sierra Leone	1983	Yes	No
Sudan	1983	Yes	Yes
Tanzania	1983	Yes	No
Togo	1984	No ^{5/}	--
Uganda	1984	Yes	Yes
Venezuela ^{3/}	1983	Yes	No
Viet Nam	1983	Yes	No
Western Samoa	1984	Yes	Yes
Zaire	1983	Yes	Yes
Zambia	1983	Yes	Yes

Sources: Staff reports for Article IV consultation discussions or Executive Board papers dealing with use of Fund resources.

^{1/} Refers to the most recent year of Article IV consultation decisions or approval of use of Fund resources when the country was known to have had payments arrears during January 1983-May 1984. In instances in which Executive Board decisions were not adopted since 1983, the record of the most recent decision is shown.

^{2/} No members maintained external payments arrears under the provisions of Article XIV of the Fund's Articles. Unless otherwise noted, approvals were granted on a temporary basis.

^{3/} Member has accepted obligations under Article VIII of the Fund's Articles of Agreement.

^{4/} Executive Board discussion had not yet taken place as of end-May 1984.

^{5/} Payments arrears were treated as defaults and were therefore not considered to constitute an exchange restriction subject to Article VIII.

^{6/} Payments arrears were identified after the approval of the stand-by arrangement (February 25, 1983).

^{7/} The maintenance of payments arrears was approved in April 1983, at the time of a review under stand-by. At the conclusion of 1983 Article IV consultation in October 1983 approval was not granted.

^{8/} The maintenance of payments arrears was approved in August 1983, at the time of approval of the stand-by arrangement. At the conclusion of the 1984 Article IV consultation in June 1984, approval was not granted.

^{9/} Debt service, restructured in principle with the Paris Club and commercial banks, was considered as external payments arrears at the time the Executive Board considered a stand-by arrangement with Peru in April 1984, and temporary approval was given for the resulting exchange restriction.



Office Memorandum

Mr. Finch

CO

March 14, 1984

MEMORANDUM FOR FILES

Subject: Meeting with Mr. Clark, Alternate Executive Director for the United Kingdom, 3:00 p.m., March 13, 1984

Mr. Huh and I met with Mr. Clark, at his request, and with Miss Bulloch, to discuss the general topic of performance criteria in Fund programs relating to external payments arrears.

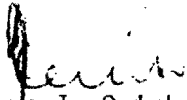
The discussion began with a review of the general aspects of Fund policies on external payments arrears as stated in the 1982 and 1983 papers on external payments arrears of Fund members (EBS/82/57 and EBS/83/12). It transpired that Mr. Clark's specific concerns arose from the recent Board meeting on Sudan, and the ongoing issue of Nigeria's arrears and their settlement. Mr. Clark said that he himself, and also Mr. Erb in his conversations with him, had been concerned as to whether the elimination of arrears at the time of general Paris Club agreements allowed the Fund sufficient discretion with respect to any subsequent problems in successfully concluding the bilateral agreements. I said that, generally speaking, bilaterals had been successfully concluded, and that the policy for the arrears reduction targets of considering elimination to have occurred at the time of general Paris Club agreement (EBS/83/12, page 12) had given support to the Paris Club. However, should difficulties be experienced in the bilaterals, it was open to the Fund to consider the arrears to have been reinstated. Most often, where all creditors were not subject to continuing delays, a discriminatory feature could also be introduced to the continuing exchange restriction. The Fund therefore had several jurisdictional and related channels available for intervening in the case of bilateral difficulties, or even more generalized difficulties.

Mr. Clark's second inquiry related to the problems of getting all parties to participate in the rescheduling exercise, and of ensuring inter-creditor equity. I noted that the arrears reduction criteria had often been used as a device to trigger the program if rescheduling had not proceeded according to a minimum schedule, as both rescheduling and cash payments had been counted against the arrears reduction targets. Even where the debtor took a more or less unilateral approach, the emergence of insuperable difficulties would be signaled by a slowing of the rundown of arrears as creditors took up the offer, perhaps over several years. Depending on the phasing of the program targets, the use of Fund resources could be blocked by the slowing. As for the treatment of those included, and not included, in the negotiations, nondiscrimination did not necessarily mean a pro rata treatment, owing to the mix of LIFO, FIFO, and other considerations. Even mathematically it was difficult to ascertain precisely comparable treatment when different maturities and instruments were

involved. However, there was no doubt that the general principle of non-discrimination should shape the procedures for obtaining negotiated settlements.

Finally, Mr. Clark asked how the quantitative targets for arrears reduction were arrived at, and whether creditor groups were consulted, with particular reference to Nigeria. I said that the numbers were a balance of medium-term balance of payments prospects, and available Fund and non-Fund financing, including that from rescheduling. Informal contacts were made with creditor groups in assessing these latter elements.

I mentioned to Mr. Clark that we were presently working on a paper that dealt with many of these issues; namely, the paper on the Fund's role in settlements of overdue financial obligations. I did mention also that the issues were largely those of greater Fund involvement at the level of individual transactions or groups of transactions--with implications for the Fund's staff resources.


Peter J. Quirk
Division Chief

Exchange Restrictions Division
Exchange and Trade Relations Department

cc: Mr. Finch ✓
Mr. Kanesa-Thasan



INTERNATIONAL MONETARY FUND
WASHINGTON, D. C. 20431

CABLE ADDRESS
INTERFUND



February 15, 1983

Dear Mr. Williamson:

I am enclosing a list of the countries maintaining external payments arrears as of the end of 1982, or according to our latest information, in confirmation of our telephone conversation today.

Very truly yours,

Peter Quirk

Peter J. Quirk
Division Chief
Exchange Restrictions Division
Exchange and Trade Relations Department

Enclosure

Mr. John Williamson
Institute for International
Economics
11 Dupont Circle, Suite 620
Washington, DC 20036

cc: Mr. Finch ✓

February 15, 1983

External Payments Arrears Outstanding, End-1982

Argentina
Benin
Bolivia
Central African Republic
Chad

Comoros
Congo
Costa Rica
Dominican Republic
El Salvador

The Gambia
Ghana
Guinea
Guinea-Bissau
Guyana

Haiti
Honduras
Liberia
Madagascar
Mali

Mauritania
Mexico
Nicaragua
Nigeria
Romania

Sierra Leone
Sudan
Tanzania
Togo
Uganda

Viet Nam
Western Samoa
Zaire
Zambia



Office Memorandum

cc: Mr. Guillian
Mr. Buer
m

TO : Mr.C. David Finch
FROM : José Luis Feito
SUBJECT : EBS/83/12 - Costa Rica

DATE: January 17, 1983

Along the lines of Mr. Senior's memorandum of January 14, my Costa Rican authorities have also expressed interest in the data on the country's arrears appearing in EBS/83/12.

I would very much appreciate a written communication explaining these figures so that I may send it to them.

cc: Mr. Miguel Bonangelino





Office Memorandum

TO : Mr. Senior

DATE January 18, 1983

FROM : Donald K. Palmer *DK*

SUBJECT : Mexico--External Payments Arrears

In response to the request conveyed in your memorandum to Mr. Finch of Friday, January 14, 1983, this note sets out the basis of datum on Mexico's external payments arrears contained in the Executive Board special report on "External Payments Arrears of Fund Members, 1981-82" (EBS/83/12) circulated to Directors on a confidential basis on January 12, 1983.

The amount of SDR 7,504 million shown in Table 1 of EBS/83/12 was an estimate for December 1982 of external payments that were not settled on schedule. The estimate was derived from data provided to the staff mission in Mexico City in November and data provided by the Mexican authorities to foreign commercial banks in the process of debt restructuring. It represents private amortizations due, private short-term debt rolled over after August 1982, and other private current payments; this approach is consistent with the data in the first paragraph of page 49 of "Mexico--Use of Fund Resources--Extended Fund Facility and First Credit Tranche" (EBS/82/208, Supplement 1, 12/13/82). This figure, which is comparable in its treatment of amounts pending rescheduling to those shown for other countries in Table 1, was converted from U.S. dollars to SDRs at the rate of SDR 1.10634 = US\$1 outstanding as of late-December, the cut-off point for the information shown in EBS/83/12. To a large extent the level of arrears is expected to be reduced on January 31 as foreign commercial banks roll their principal over following the agreement by Mexico with commercial banks to constitute special deposits for the repayment of interest on private debt.

cc: Western Hemisphere Department

bcc: Messrs. Guitian, Loser

**Mexico: Arrears and Short-Term Postponement of
Bank Debt December 1982**

	In millions of	
	SDRs	US\$
Amounts subject to rollover <u>1/</u>	<u>10,806</u>	<u>11,955</u>
Public sector debt	6,833	7,599
Medium- and long-term debt	(1,123)	(1,242)
Short-term debt	(5,710)	(6,317)
Nationalized banks debt	3,973	4,396
Private sector obligations (estimated)	<u>7,504</u>	<u>8,300</u>
Amortization and rollover of short-term debt	5,875	6,500
Interest payments due to commercial banks	815	900
Other current payments	<u>814</u>	<u>900</u>
Total	18,310	20,295

Sources: "Mexico: Economic and Financial Statistics", Ministry of Finance and Public Credit, November 8, 1982, Tables 13B and 15C; Mexican authorities; and Fund staff estimates.

1/ Amounts subject to a rollover period of 90 days from August 23 to November 23, 1982, plus payments due in remainder of 1982.



Office Memorandum

*Mr. Beveridge
cc: Mr. Gubman
Mr. Loret
Mr. Quirk*

TO : Mr. C. David Finch

DATE: January 14, 1983

FROM : Miguel A. Senior *mf.*

SUBJECT : Mexico

I was taken aback by the publication of Mexico's arrears in EBS/83/12. Would you be kind enough to let me know how that figure was arrived at?

I would be most grateful if you could answer me in a written communication to send it to my Mexican authorities who have shown extreme interest in the data appearing in EBS/83/12.

cc: Mr. Sterie T. Beza



EBS/83/12

a Cor. 1 of 2

CONFIDENTIAL

January 12, 1983

To: Members of the Executive Board
From: The Secretary
Subject: External Payments Arrears of Fund Members, 1981-82

The attached paper reviewing developments in the payments arrears situation of members is circulated for the information of the Executive Directors.

Att: (1)

INTERNATIONAL MONETARY FUND

External Payments Arrears of Fund Members, 1981-82

Prepared by the Exchange and Trade Relations Department

(In consultation with other departments)

Approved by C. David Finch

January 10, 1983

I. Introduction

Developments in 1980 and the first three quarters of 1981 relating to external payments arrears maintained by Fund members, steps taken by members to deal with arrears, and the implementation of the Fund's policies in this area were reviewed in a paper circulated for the information of the Executive Board in early 1982. ^{1/} That paper indicated that information on payments arrears would be further developed and updated more frequently. The present paper draws together and analyzes newly available information for 1981 and for the first three quarters of 1982, and revised data for earlier years.

The paper is organized as follows: Section II reviews major developments relating to members' arrears in the aggregate, their relationship to other macroeconomic aggregates, and conclusions derived from these relationships. Section III surveys developments in the broad categories of payments

^{1/} "External Payments Arrears of Fund Members, 1980-81" (EBS/82/57, 3/31/82). Payments arrears constitute an exchange restriction under Article VIII, Section 2(a) and Article XIV, Section 2 when the authorities of a country are responsible for undue delays in approving applications or in meeting bona fide requests for foreign exchange for current international transactions, as defined in Article XXX, Section (d). When a government or a government entity whose financial operations form part of the budgetary process fails to meet an external payments obligation due to a lack of domestic currency, the resulting arrears are considered to be defaults rather than payments arrears constituting an exchange restriction within the meaning of Article VIII. Similarly, payments arrears incurred by governments participating in a common central bank are treated as defaults when they are due to the government's inability to obtain domestic currency with which to purchase needed foreign exchange from the common central bank. Although the above distinction is relevant for the purposes of Articles VIII and XIV, in the context of the Fund's policies on the use of its resources, defaults and other forms of arrears involving current and capital payments are viewed as having the same broad macroeconomic character and consequences, and are therefore treated in the same manner.

arrears in individual countries, and means of reducing arrears. Section IV reviews the implementation of the Fund's policies with respect to payments arrears, particularly in the context of the use of the Fund's resources. A summary is presented in Section V.

II. Recent Developments

1. The overall arrears situation

External payments arrears incurred by Fund members have risen sharply in the first three quarters of 1982 after remaining at a virtually constant level during the previous five years (Table 1). A salient feature has been the emergence of arrears in several larger and more developed economies.

On the basis of the most recent information available to the staff, total arrears have nearly trebled since end-1981, from SDR 6.1 billion to SDR 18.1 billion. Two countries in which large arrears emerged were Mexico (SDR 7.5 billion) ^{1/} and Argentina (SDR 1.6 billion); arrears are also reported to have emerged recently in Nigeria, although the extent of the problem in that country is not yet known. The size of arrears emerging in Mexico, in particular, is unprecedented in recent years; but even excluding Mexico, total arrears have increased by 72 per cent in 1982. ^{2/}

Major factors underlying the deterioration in the arrears situation have been the continued widespread balance of payments weakness of developing countries, reflecting the weak economic climate, a degree of disorderliness in matching foreign exchange flows with commitments, historically high costs of debt servicing, and circumstances peculiar to the individual countries concerned. For these individual countries, arrears are a lagging, rather than a leading, indicator of severe balance of payments problems.

The record indicates that arrears, once accumulated, tend to persist for a number of years. In some cases, the initial accumulations are so large that their liquidation presents severe problems. The number of countries incurring arrears has been rising almost continuously and of the 42 countries incurring arrears during 1975-82, only 8 countries have managed to eliminate them. ^{3/} Of the remaining countries, 10 experienced virtually continuously rising arrears in recent years, whereas only 3 countries demonstrated continuously falling

^{1/} Includes approximately SDR 1.5 billion of interest payments owing to foreign commercial banks and other entities.

^{2/} Other countries that have incurred arrears exceeding SDR 1 billion since 1975 are: Costa Rica (in 1982), Romania (in 1982), Sudan (in 1980-1982), Turkey (in 1977-80), and Zaire (in 1979).

^{3/} Egypt, Gabon, Grenada, Jamaica, Peru, Senegal, Somalia, and Turkey. In addition, Dominican Republic eliminated arrears for two years before re-incurring them.

Table I. External Payments Arrears Outstanding, 1976-1982 1/

(In millions of SDRs; end of period)

	1976	1977	1978	1979	1980	1981 2/	1982 2/	1982 arrears as per-	
								1981 imports 2/	Level of gross official international reserves 2/
Argentina	--	--	--	--	--	--	1,594	27	64
Benin	...	--	--	22	21	18	...	6	199
Bolivia	--	--	--	42	148 3/	80	111 4/	84	84
Central African Rep.	35	39	8	42	63	1	9	6	37
Chad	9	9	22	39	52	...	...	...	...
Comoros	--	--	--	--	--	x	x 5/	...	5
Congo	4	4	23	31	8	5	3	--	--
Costa Rica*	--	--	--	--	222	552	1,110	97	436
Dominican Republic	11	--	--	17	37	54	155 5/	12	306
Egypt	312 6/	862 7/	--	--	--	--	--	--	--
El Salvador*	--	--	--	--	32	56	52	6	49
Gabon*	--	430	339	--	--	--	--	--	--
The Gambia*	--	--	--	--	10	17	12 5/	15	286
Ghana	192	201	393	324	269	434	535	82	455
Grenada	x	x	2	1	--	--	--	--	--
Guinea	90	119	151	169	91	140	130	36	7,927
Guinea-Bissau	7	7	8	5	7	...	...	...	...
Guyana	--	27	17	20	23	43	77 5/	12	262
Haiti*	--	--	--	--	--	17	18	6	124
Honduras*	--	--	--	--	--	9	75 8/	9	73
Jamaica*	--	22	48	42	89	39	--	--	--
Liberia*	--	--	--	--	--	6	42	10	436
Madagascar*	5	7	11	13	175	103	145	32	527
Mali*	--	11	18	27	38	51	45 5/	14	355
Mauritania	x	9	23	15	39	21	...	6	17
Mexico	--	--	--	--	--	--	7,504 3/	38	389
Nicaragua	--	--	58	363	188	50	15 9/	2	14
Nigeria	--	--	--	--	--	--	... 10/	...	...
Peru*	...	...	115	--	--	--	--	--	--
Romania*	--	--	--	--	--	981	2,122 8/	36 11/	245
Senegal*	...	...	...	...	7	12	--	--	--
Sierra Leone	4	15	35	54	72	137	252	100	2,800
Somalia*	--	--	--	13	35	13	--	--	--
Sudan*	241	572	597	878	1,081	1,505	2,070	98	7,188
Tanzania	4	2	55	126	254	294	376 12/	39	940
Togo*	--	8	34	21	25	60	152 12/	56	105
Turkey*	202	1,710	1,523	1,769	1,266	275	--	--	--
Uganda*	29	21	63	68	172	130	113 5/	34	350
Viet Nam	--	--	--	--	--	33	35 4/	14 11/	79
Western Samoa	--	--	--	--	1	7	10	14	306
Zaire	385	671	950	1,118	433	428	...	39	375
Zambia	223	394	496	351	461	500	825	79	908
Total	1,753	5,140	4,989	5,570	5,319	6,130	18,054		

Memorandum item:

Number of countries with arrears:	21	24	24	26	29	35	34 13/
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Sources: Country authorities; and staff estimates.

1/ The Table shows data on countries known to have had external payments arrears in any year during the period 1975-1982, or other dates indicated in the footnotes. Defaults, i.e., payments arrears incurred by governments participating in common central bank arrangements (Bank of Central African States (BEAC), Central Bank of West African States (BCEAO), and Eastern Caribbean Currency Authority (ECCA)) and which resulted from the government's inability to obtain domestic currency with which to purchase needed foreign exchange from the common central bank, as well as those incurred by the government or a government entity whose financial operations form part of the budgetary process, are included in these figures. In the former case, since it is not possible to distinguish between domestic and external arrears, total arrears are shown. Overdue financial obligations to the Fund are excluded from the table.

2/ Latest estimates available in 1981 and 1982; total based on end-1981 figures, where 1982 figures not available. Totals for ratios to imports and reserves are unweighted averages.

3/ Includes payments arrears postponed by agreement with creditor banks. In the amount shown for Mexico, public sector and nationalized bank debt totalling approximately SDR 11 billion subject to a roll-over period of 90 days from August 23, 1982 (recently extended by a further 120 days) and due in the remainder of 1982 is not included.

4/ August 1982.

5/ June 1982.

6/ April 1976.

7/ April 1977.

8/ November 1982.

9/ March 1982.

10/ Payments delays are reported to have emerged. The nature and amount of arrears are being clarified with the authorities.

11/ As a ratio of convertible currency imports.

12/ October 1982.

13/ Includes countries for which recent data are not available.

Symbols:

* Financial program supported by use of Fund resources in effect in November 1982 (including inoperative arrangements).

x Arrears less than SDR 0.5 million.

totals. ^{1/} This persistent and, to a certain degree, self-perpetuating nature of arrears underlines the importance for member countries of policies aimed at avoiding their initial incurrence.

In part, the present exceptionally high aggregate level of arrears may be viewed as transitional. In a number of countries, including several with the largest arrears, negotiations aimed at rescheduling overdue and future payments obligations are either under way or are likely to commence soon, following a marked decline in overall amounts rescheduled in 1981 and in 1982 (Chart 1). For a number of countries, rescheduling exercises are presently under way. In the case of Mexico, well over one half of the presently overdue payments are subject to a three-month postponement by creditors (involving public and nationalized banks' amortization payments on mostly short-term debt due in the period August 23-November 23, 1982) which was recently extended by a further four months. Nevertheless, as was noted in EBS/82/57 (page 2), total deferrals of external contractual obligations, comprising both outstanding rescheduled payments obligations and external payments arrears, are the appropriate indicator of the risk attaching to these assets. Substitution of new contracts for the unilateral rolling over implicit in arrears generally does not in itself obviate the problem. In some instances, in which an inappropriate bunching of maturities is an important factor, the rescheduling may give rise to a more sustainable balance of payments, independently of other actions. More often, however, the rescheduling represents an opportunity to "buy time" while adjustment programs are introduced aimed at generating the necessary strengthening of the overall balance of payments.

Developments in delays and deferrals of members' international payments relative to imports and debt are shown in Chart 1 and Appendix Table I. Viewed from the perspective of total delays and deferments, the risk situation has not deteriorated quite as markedly as the trebling of arrears noted above would suggest. After remaining virtually constant in 1980 and 1981 at just over 5 per cent, the ratios of combined arrears and outstanding amounts rescheduled both to imports and to debt have approximately doubled in 1982, to 12.7 and 10.7 per cent, respectively. To a limited degree, this development had been anticipated in spreads over LIBOR paid by borrowers from developing countries, which rose by approximately one half of one percentage point from 1980 to the second quarter of 1982. ^{2/} It has also been reflected in the high international structure of real interest rates in part attributable to balance sheet problems experienced by both domestic and foreign debtors.

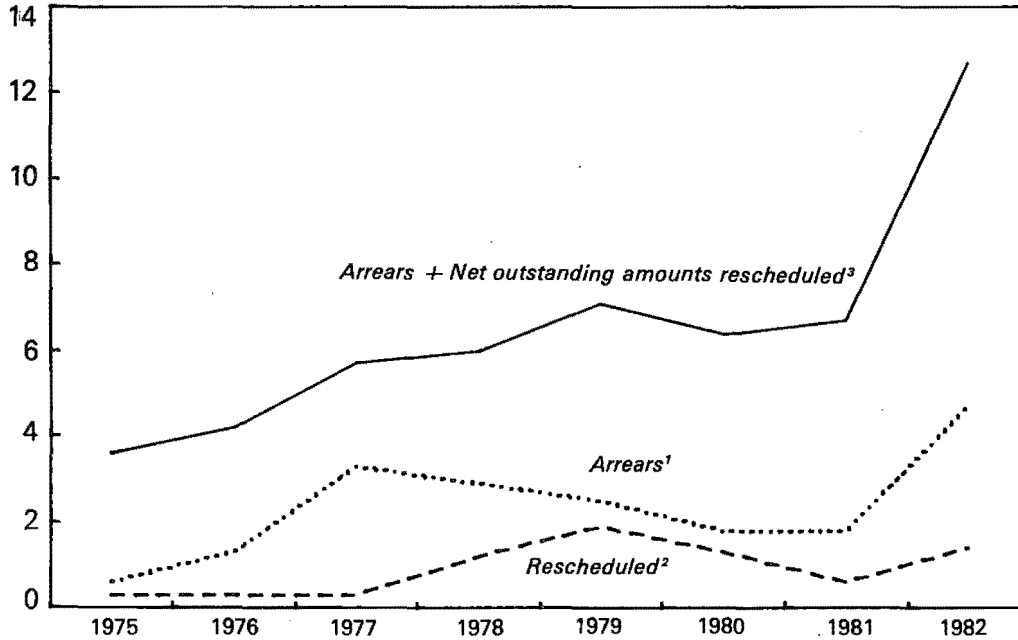
^{1/} Countries in the former group are Costa Rica, Dominican Republic, Ghana, Guyana, Honduras, Sierra Leone, Sudan, Tanzania, Togo, and Zambia. Those in the latter group include Benin and Nicaragua (both of whom have almost eliminated arrears in 1982), and Uganda.

^{2/} The following are mean spreads in per cent over LIBOR of public sector and state-guaranteed loans (data from the Bank of England Quarterly Bulletin, September 1982):

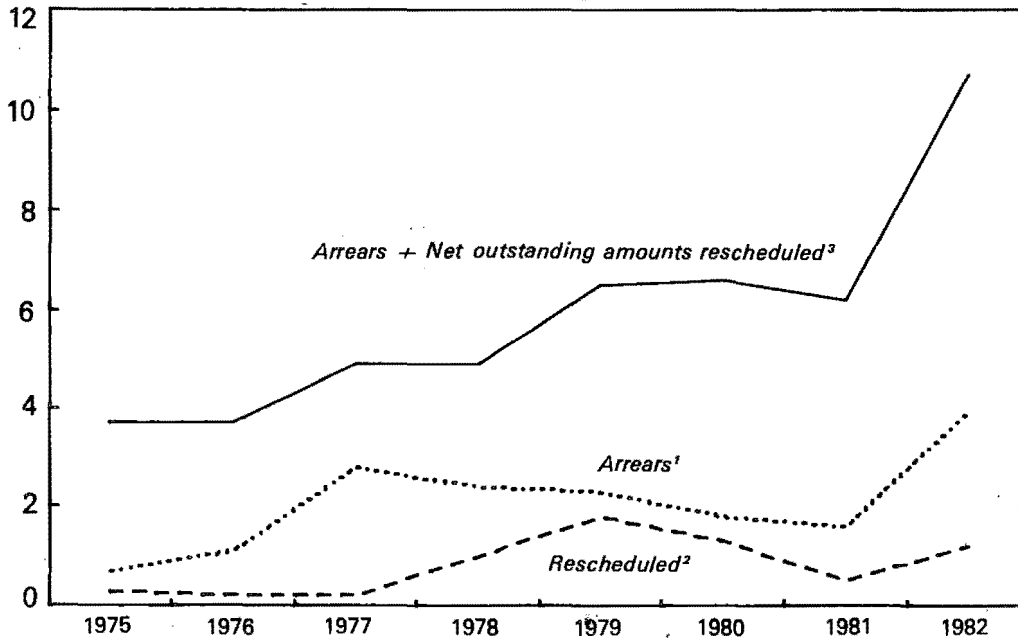
	1980	1981	1982	
			Q1	Q2
Major OECD	0.56	0.49	0.49	0.53
Minor OECD	0.69	0.60	0.49	0.51
Developing countries	0.90	1.20	1.35	1.35

PAYMENTS DELAYED AND DEFERRED BY FUND MEMBERS, 1975-82

Per cent of imports of non-oil developing countries



Per cent of total outstanding debt of non-oil developing countries



Sources: World Bank, *World Debt Tables*, December 1982; Organization for Economic Cooperation and Development, *External Debt of Developing Countries*; International Monetary Fund, *International Financial Statistics* (various issues); and staff estimates.

¹From Table 1 and Appendix Table I.

²Amounts rescheduled in each year (flows) are with respect to official development assistance countries and major private creditors.

³Sum of arrears and outstanding rescheduled amounts, net of estimated payments in respect of rescheduled amounts, (stocks as of the end of the indicated year), as a per cent of total imports and of total outstanding debt respectively.

2. Developments in 1982

Since the end of 1981, payments arrears are known to have emerged in 3 countries (Argentina, Mexico, and Nigeria) and 4 countries (Jamaica, Senegal, Somalia, and Turkey) eliminated their payments arrears. ^{1/} Hungary incurred arrears in the course of 1982, but had eliminated them by end-November. During the first three quarters of 1982, payments arrears were known to have increased in 18 countries (Bolivia, Central African Republic, Costa Rica, Dominican Republic, Ghana, Guyana, Haiti, Honduras, Liberia, Madagascar, Romania, Sierra Leone, Sudan, Tanzania, Togo, Viet Nam, Western Samoa and Zambia), and to have declined in 7 countries (Congo, El Salvador, The Gambia, Guinea, Mali, Nicaragua, and Uganda). In one country (Comoros) the level of payments arrears remained unchanged.

For three countries only end-1981 data are available. In 1981 the level of payments arrears decreased in all of these countries, but the reductions were modest. ^{2/} It is unlikely that any of the countries for which 1982 information is not available eliminated payments arrears since the end of 1981.

In the countries for which an estimate of the level of payments arrears in 1982 is available, the ratio of payments arrears to imports ranged from 2 per cent (Nicaragua) to 100 per cent (Sierra Leone). In 6 other countries (Bolivia, Costa Rica, Ghana, Sudan, Togo, and Zambia), the level of payments arrears exceeded 50 per cent of their 1981 imports. With the exception of 5 countries, which are identified as having payments arrears in 1982, the ratio of payments arrears to gross international reserves exceeded 50 per cent. In 21 of these countries the ratio was more than 100 per cent, and in the following 6 countries it exceeded 500 per cent (the ratio in brackets): Guinea (7,927); Madagascar (527); Sierra Leone (2,800); Sudan (7,188); Tanzania (940); and Zambia (908).

III. Types of Arrears and Means of Reducing Them

1. Types of arrears

Information concerning the various balance of payments categories of payments arrears since 1980 is presently available for 30 countries (Table 2), reflecting some improvement in the quality of data for payments arrears during the past two years. In some instances, however, arrears data undoubtedly

^{1/} In EBS/82/57 it was mentioned that 31 countries were known to have incurred payments arrears at the end of 1981 and that the total amount was SDR 5.4 billion. Since then, the following new information became available to the staff: (1) Benin did not eliminate payments arrears before the end of 1981; and (2) Comoros, Honduras, and Western Samoa were found to have had payments arrears at the end of 1981. In addition, figures for a number of countries have been revised.

^{2/} In two countries (Chad and Guinea Bissau) the most recent data available are for end-1980.

Table 2. External Payments Arrears, by Type of Payments, 1980-82

(In per cent of total arrears) 1/

	1980				1981				1982			
	Import payments	Invisible payments 2/	External debt service payments		Import payments	Invisible payments 2/	External debt service payments		Import payments	Invisible payments 2/	External debt service payments	
			Interest	Capital			Interest	Capital			Interest	Capital
Argentina	--	--	--	--	--	--	--	--	50	5	45	--
Benin	--	--	21	79	--	--	21	79	...	...	...	...
Bolivia	--	--	28	72	--	--	42	58	--	--	45	55
Central African Rep.	--	--	23	77	--	--	22	78	--	--	23	77
Congo	--	--	31	69	--	--	6	94	--	--	--	100
Costa Rica	100	--	--	--	44	--	23	33	24	--	40	36
El Salvador	80	10	4	6	68	--	...	32	75	--	--	25
The Gambia	86	14	--	--	83	17	--	--	84	16	--	--
Ghana	40	44	3	13	55	34	3	8	59	31	2	8
Guinea	7	--	25	68	--	--	22	78	--	--	15	85
Guyana	100 3/	...	--	--	100 3/	...	--	--	88	--	6	6
Haiti	...	...	...	...	66 3/	...	--	34	86	--	--	14
Honduras	--	--	--	--	--	--	--	100	36 3/	...	--	64
Jamaica	66 3/	...	34 4/	...	66 3/	14	34 4/	...	--	--	--	--
Madagascar	68	32	9 4/	...	...	28	...	...	...	...	...	...
Mali	42	32	25	1	32	--	37	3	28	25	44	3
Mauritania	--	--	20	80	--	--	45 4/	55	...	...	...	...
Nicaragua	--	--	24	76	--	--	36	64	...	...	...	...
Romania	--	--	--	--	50	6	44 4/	...	...	...	...	...
Senegal	--	--	100 4/	...	--	...	100 4/	...	--	--	--	--
Sierra Leone	91 3/	...	1	8	74 3/	--	3 4/	23	59 3/	...	5 4/	36
Somalia	--	--	13	87	--	--	22	78	--	--	--	--
Sudan	--	--	100 4/	...	35	...	16 4/	49	28	17	-- 4/	55
Tanzania	94 3/	...	--	6	86 3/	...	--	14	88 3/	...	--	12
Togo	--	--	31 4/	69	--	--	20 4/	80	--	--	21 4/	79
Turkey	97 3/	...	3 4/	...	100 3/	--	--	--	--	--	--	--
Uganda	40	--	60 4/	...	14	...	86 4/	...	14 3/	...	86 4/	...
Viet Nam	--	--	--	--	--	--	13	87	--	--	13	87
Zaire	90	6	1	3	65 3/	...	12 4/	23	...	...	...	...
Zambia	57	43	--	--	53	47	--	--	38	47	5	10

Sources: Country authorities; and staff estimates.

1/ Table does not show data on all countries appearing in Table 1, because data on some countries do not exist or are not reliable. For 1982 the latest available data are shown.

2/ Excludes interest payments on external debt.

3/ Includes invisible payments (excluding interest payments on external debt).

4/ Includes principal.

remain overstated to the extent that applicants for foreign exchange have already satisfied their needs for foreign exchange by purchases in parallel markets, while deficiencies in reporting procedures may have led to understatement in other instances. ^{1/} The staff is continuing its efforts to ensure accurate and comprehensive information in this area.

The broad breakdown of payments arrears between import and invisible payments (excluding interest payments) and debt service payments (including interest payments) in 1982 is available for 20 countries. In 1 of these countries, payments arrears existed with respect to import and invisible payments only (The Gambia), and in 6 countries, with respect to debt service payments only (Bolivia, Central African Republic, Congo, Guinea, Togo, and Viet Nam). In the latter group of countries, separate data on payments arrears on amortization and interest payments are available in all countries. In 9 countries (Argentina, Costa Rica, El Salvador, Ghana, Guyana, Haiti, Mali, Sudan, and Zambia) in which payments arrears were maintained with respect to both import and invisible payments and debt service payments, the breakdown of arrears on payments between imports and invisibles and those on debt service payments between amortization and interest is available.

Information on payments arrears by category of payment was available for Benin, Jamaica, Mauritania, Nicaragua, Romania, and Somalia at the end of 1981, but similar information is not available for 1982, except for Jamaica and Somalia which eliminated payments arrears. Among the countries for which information is available for 1981 and 1982, the category of payments arrears changed in three countries in 1982. In 1981 Guyana incurred payments arrears with respect to import and invisible payments only and Honduras incurred payments arrears only with respect to debt service payments; in 1982, however, payments arrears emerged with respect to both import and invisible payments and debt service payments in these countries.

Available information indicates that, despite considerable variation from country to country, the ratio of total arrears on import and invisible payments to total arrears on capital payments for the membership has remained quite stable. Unweighted, the ratio is approximately one half; weighted by the size of each member's arrears, approximately two thirds to three quarters of arrears are with respect to import and invisibles payments (excluding interest payments on debt). A related development concerns the emergence in Costa Rica of arrears on interest payments on government bonds. Generally speaking, while there have been many instances of payments arrears in the international banking market, arrears with respect to government securities issued in the international capital market have been avoided.

^{1/} Overstatement may also occur when a moratorium is declared at the creditors' instigation during the course of rescheduling discussions, while at the same time payments are made into an escrow account to be released upon successful completion of the discussions.

2. Arrears reduction

As mentioned above, during the first three quarters of 1982, 7 countries reduced payments arrears (Congo, El Salvador, The Gambia, Guinea, Mali, Nicaragua, and Uganda) and 4 countries eliminated payments arrears (Jamaica, Senegal, Somalia, and Turkey). Of the 4 countries which eliminated payments arrears, only Senegal did so entirely by cash payments. Somalia eliminated payments arrears by a combination of cash payments and rescheduling, but the separate data for each are not available. Amongst the 7 countries which reduced payments arrears, Congo, The Gambia and El Salvador did so entirely by cash payments. Mali reduced its payments arrears up to June 1982 by cash payments, and further reductions are expected to be made during the rest of the year involving both cash payments and rescheduling. Uganda also reduced payments arrears by cash payments and rescheduling in 1982. As of March 1982, Nicaragua had reduced payments arrears by SDR 35 million through rescheduling outside the Paris Club framework. The cash payment portion of payments arrears reduction of Uganda was considerably higher; at least one half of the planned reduction in payments arrears during July-December 1982 (as agreed under the stand-by arrangement) is expected to be effected by cash payments. Overall, excluding the 90- and 120-day postponements for Mexico, both the reductions in arrears and the rescheduling to date in 1982 have been on a considerably smaller scale than in the preceding several years.

IV. Implementation of Fund Policies

1. Treatment in programs accompanying use of Fund resources

As of end-November 1982, stand-by or extended arrangements were in effect for the following 16 countries maintaining payments arrears at the time the programs were introduced (Table 3): Costa Rica, El Salvador, The Gambia, Haiti, Honduras, Jamaica, Liberia, Madagascar, Mali, Romania, Senegal, Somalia, Sudan, Togo, Turkey, and Uganda. In all of these arrangements, payments arrears were subject to performance criteria, as noted in EBS/82/57. All arrangements included, as a performance criterion, the standard clause stating that new exchange restrictions will not be introduced, or existing ones intensified. All programs also included, as an additional performance criterion, the undertaking that existing payments arrears would be eliminated or reduced during, or by the end of, the program period in accordance with a schedule.

In formulating the targets for the reduction of payments arrears during the program period, the staff took into account the amount of payments arrears that had been rescheduled, or was expected to be rescheduled, as well as the projected change in the level of official gross international reserves during the program period. Elimination of payments arrears by or before the end of the program period was provided for in the stand-by arrangements with Haiti, Honduras, Liberia, Romania, Senegal, Somalia, Togo, and Turkey and in the extended arrangement with Jamaica. In the arrangements that did not specify a target for the reduction of payments arrears during the program period as

Table 3. Treatment of Payments Arrears Under Stand-by or EFF Arrangements in Effect in November 1982 ^{1/}

Country	Type of arrangement, effective date, amount, 2/ per cent of quota	Total amount of payments arrears outstanding at time of program formulation (SDR million)	Limit on payments arrears specified 3/		Targeted amt. of payments arrears reduction		Ratio of targeted payments arrears reduction to total arrears		Ratio of targeted payments arrears reduction to drawing		Limit/reduction of payments arrears as a performance criterion		Rescheduling of payments arrears planned or in progress at time of program negotiation	Counter-part deposit requirement 6/
			During program period	First year of program period	During program period	First year of program period	During program period	First year of program period	During program period	First year of program period	During program period	First year of program period		
Costa Rica	EFF, 6/17/81, SDR 276.75 m. 450%	222	...	...	...	83 <u>7/8/</u>	...	38 <u>7/8/</u>	...	90	Yes	Yes	No	Yes
El Salvador*	1 yr., SB 7/16/82 SDR 43 m. 66.7%	76	...	...	19 <u>9/</u>	...	25	...	58 <u>9/</u>	...	Yes	...	No	No
Gambia	1 yr., SB 2/22/82 SDR 16.9 m. 125%	18	...	...	2 <u>10/</u>	...	11	...	25 <u>10/</u>	...	Yes	...	No	Yes
Haiti*	14 mths., SB 8/9/82, SDR 34.5 m. 100%	18	...	...	18	...	100	...	52	...	Yes	...	No	No
Honduras	13 mths., SB 11/5/82 SDR 76.5 m. 150%	75	...	...	75	...	100	...	98	...	Yes	...	Yes	Yes
Jamaica	EFF, 4/13/81 SDR 477.7 m. 430%	103 (17) <u>11/</u>	...	...	...	68 <u>8/</u> (17) <u>12/</u>	...	66 <u>8/</u> (100) <u>12/</u>	...	38 (15) <u>12/</u>	Yes	Yes	No	Yes
Liberia	14 mths., SB 8/26/81, SDR 55m. 99.1%	9	...	...	9 <u>8/</u>	...	100 <u>8/</u>	...	16 <u>8/</u>	...	Yes	...	Yes <u>13/</u>	No
Madagascar*	1 yr., SB 7/9/82, SDR 51m. 100%	145	...	yes	...	49 <u>8/12/</u>	...	34 <u>8/12/</u>	...	240 <u>8/12/</u>	Yes	Yes <u>12/</u>	Yes	No
Mali*	1 yr., SB 5/24/82 SDR 30.4 m. 75%	54	...	...	35	...	65	...	115	...	Yes	...	Yes	No
Romania	3 yr., SB 6/15/81 SDR 1102.5 m. 300%	982 <u>14/</u>	...	...	...	982 <u>12/15/</u>	...	100 <u>12/15/</u>	...	42 <u>12/16/</u>	...	Yes	Yes	No
Senegal	1 yr., SB 9/11/81 SDR 63 m. 100%	9	...	...	9 <u>8/</u>	...	100 <u>8/</u>	...	14	...	Yes	...	Yes	No

Table 3 (concluded). Treatment of Payments Arrears Under Stand-by or EFF Arrangements in Effect in November 1982 ^{1/}

Country	Type of arrangement, effective date, amount, ^{2/} per cent of quota	Total amount of payments arrears outstanding at time of program formulation (SDR million)	Limit on payments arrears specified ^{3/}		Targeted amt. of payments arrears reduction		Ratio of targeted payments arrears reduction to total arrears		Ratio of targeted payments arrears reduction to drawing		Limit/reduction of payments arrears as a performance criterion		Rescheduling of payments arrears planned or in progress at time of program negotiation	Counterpart deposit requirement ^{6/}
			During program period	First year of program period	During program period	First year of program period	During program period	First year of program period	During program period	First year of program period	During program period	First year of program period		
Somalia*	18 mths., SB 7/12/82, SDR 173.9%	7	yes	...	7 ^{17/}	...	100 ^{17/}	...	12 ^{17/}	...	Yes	...	Yes	No
Sudan	1 yr., SB 2/22/82, SDR 198 m. 150%	1,505 ^{18/}	yes ^{19/}	...	...	...	...	...	...	...	Yes	...	Yes	No
Togo	2 yr., SB 2/13/81, SDR 47.5 m. 166.7%	39	...	...	39 ^{8/}	20 ^{8/}	100 ^{8/}	51 ^{8/}	82 ^{8/}	70 ^{8/}	Yes	Yes	No	No
Turkey	3 yr., SB 6/18/80, SDR 1,250 m. 625%	1,810 (0) ^{20/}	...	Yes (...) ^{20/}	1,810 (0) ^{20/}	...	100 (0) ^{20/}	...	145 (0) ^{20/}	...	Yes (Yes) ^{20/}	Yes (...) ^{20/}	Yes (Yes) ^{20/}	No (No) ^{20/}
Uganda*	1 yr., SB 8/11/82, SDR 112.5 m. 150%	113	...	...	10 ^{21/}	...	9 ^{21/}	...	27	...	Yes	...	Yes	Yes

^{1/} Includes imperative arrangements. Countries with asterisk entered into stand-by or EFF arrangements since the issuance of External Payments Arrears of Fund Members 1980-81 (EBS/82/57, 3/31/82), i.e., since April 1, 1982.

^{2/} Original amount; augmented amount included only in cases where it was stated in the relevant Board paper in anticipation of coming into operation of the Enlarged Access Policy.

^{3/} The standard clause on introduction and intensification of exchange restrictions also applies to the incurrence of new payments arrears. The answer to the question therefore indicates only cases where a limit (i.e., freeze) on outstanding payments arrears is specifically provided for in the program.

^{4/} Ratio of payments arrears reduction specified for the program period to total amount of arrangement.

^{5/} Ratio of payments arrears reduction during the first year of program period to drawings during the first year of program period, unless otherwise stated.

^{6/} One hundred per cent unless otherwise indicated.

^{7/} Calendar 1981.

^{8/} Through cash payments only.

^{9/} Calendar 1982.

^{10/} First four months of the program period.

^{11/} Amount outstanding at the beginning of the second year of the EFF arrangement (April 1, 1982).

^{12/} During calendar 1982.

^{13/} Letter of intent indicates that, no later than May 31, 1982, external arrears shall be fully paid off or rescheduled.

^{14/} Payments arrears emerged after the conclusion of the stand-by arrangement. Information on the treatment of payments arrears therefore refers to the second-year program under the stand-by arrangement.

^{15/} Second year of the program period (see footnote ^{14/}).

^{16/} Includes amounts undrawn in 1982 and can be drawn only after the completion of a review by the Fund of rescheduling of payments arrears in progress.

^{17/} Projected figure up to June 1982.

^{18/} Includes only payments arrears owed to Paris Club members.

^{19/} With respect to debt which has been rescheduled.

^{20/} July 1982 (beginning of third year program).

^{21/} July-December 1982.

a whole (Costa Rica and Madagascar), a target for the first year of the arrangement (or first six months in the case of a one-year stand-by arrangement) was specified, and further reductions of payments arrears in the course of periodic reviews of the program were specified as a performance criterion for subsequent phased drawings. Under one multi-year arrangement (a three-year stand-by arrangement with Romania), elimination of payments arrears was specified before the end of the program period. In the cases of the stand-by arrangements with El Salvador, The Gambia, Madagascar, Mali, and Uganda, a partial reduction in outstanding payments arrears during the program period was specified. Jamaica's extended arrangement incorporated a reduction in outstanding payments arrears during the first year of the program and elimination before the end of the second program year.

The amount of targeted reductions of payments arrears varied considerably from country to country, depending on the balance of payments outlook and prospects for rescheduling. The ratio of targeted payments arrears reduction to total payments arrears was relatively low in El Salvador (25 per cent), The Gambia (11 per cent), and Uganda (9 per cent). In other countries, the targeted reductions exceeded one third of the outstanding totals. To facilitate orderly reductions of payments arrears, full counterpart deposit requirements in domestic currency were in force in five countries (Costa Rica, The Gambia, Honduras, Jamaica, and Uganda). In all of these instances, the institution of these deposit requirements took place in the context of negotiations for the use of the Fund's resources. In Costa Rica and Honduras the monetary authorities assumed the obligations involving arrears.

As of end-November 1982, three countries maintaining payments arrears that had an arrangement with the Fund for use of resources were unable to draw because of the nonobservance of some of the performance criteria, including that relating to payments arrears. Under the extended arrangement which was approved in June 1981, Costa Rica undertook to reduce payments arrears by at least SDR 83 million by the end of 1981; this performance criterion was not observed. ^{1/} The performance criterion regarding payments arrears in the stand-by arrangement with Sudan, which entered into force in February 1982, provided that no payments arrears would be accumulated in respect of rescheduled payments arrears. By the end of March 1982, Sudan incurred payments arrears on previously rescheduled payments arrears estimated at SDR 95 million, and the amount of payments arrears is known to have increased since. Under the two-year stand-by arrangement, approved on February 13, 1981, Togo undertook to reduce government payments arrears through cash payments in accordance with an agreed schedule during 1981, and drawings during the second year of the stand-by arrangement were contingent on reaching understandings with the Fund before January 31, 1982 on the schedule of payments arrears reduction during 1982. Following the initial purchase (March 11, 1981), the arrangement became inoperative because there was a substantial accumulation of arrears rather than a reduction. The

^{1/} Subsequently, on December 22, 1982 the Executive Board approved a one-year stand-by arrangement (EBS/82/213, 11/29/82).

Paris Club rescheduling for 1982 did not take place because the condition for the rescheduling that the authorities reach understandings with the Fund before January 31, 1982 on policies for 1982 (including arrears reduction) was not met.

In the context of financial programs it has also been necessary to take into account reductions in arrears resulting from rescheduling agreements, both multilateral and bilateral. In several instances of stand-by or extended arrangements in effect as of end-November 1982, the targets for reducing arrears specified cash payments only (Costa Rica, Jamaica, Liberia, Madagascar, Senegal, and Togo) or, alternatively, the reduction targets referred solely to rescheduled amounts (Sudan). In the other instances (El Salvador, The Gambia, Haiti, Mali, Somalia, and Uganda), the means by which the arrears were to be reduced (cash payment or rescheduling) was not specified, so that either form of reduction would be counted toward the target. In none of the programs did the targets specify amounts of arrears to be reduced by rescheduling, as this has been considered to be a matter to be decided by the creditor groups concerned. However, given that the scale of rescheduling is an important variable in the formulation of a program--having implications for both domestic and external major target variables--it has been considered useful, for the purpose of establishing the member's right to purchase from the Fund or the need for program review, to have performance under the program contingent on the successful conclusion by debtor and creditors of a general agreement on rescheduling. The contingency has generally been implicit, with some amount of rescheduling being necessary, in attainment of the arrears performance criterion. This approach has been found to be particularly useful where: (1) some doubts exist regarding the likely outcome of negotiation; and (2) the amounts involved are large enough to have substantive implications (outside normal margins of error) for general performance under the program.

A secondary consideration in such circumstances relates to the point in the process of obtaining agreement, in the Paris Club or in other multilateral fora, at which the arrears may be considered to be eliminated. As a practical matter, general agreement between the debtor and representative creditors establishing new contractual obligations has been considered sufficient to warrant treatment of arrears as having been eliminated. In other instances in which a bilateral ratification of these agreements does not subsequently take place, these are most appropriately dealt with on the merits of the particular situation. It has not been considered desirable, however, to treat indefinite and temporary postponements or moratoria which do not establish new contractual arrangements and a due date with some precision as constituting elimination of arrears, for the reasons that they are subject to reversal, and that the basic economic problem arising from the "old" maturity structure of payments due has not been resolved. Such transitional arrangements, however, have been reflected in the phasing of the performance criteria.

2. Policies under the Fund's Article VIII

External payments arrears incurred or maintained by member countries constitute an exchange restriction subject to approval under Article VIII of the Fund's Articles. 1/ The established policy under Article VIII is that, following determination that payments arrears maintained by the member constitute an exchange restriction within the meaning of that Article, approval for the maintenance of the restriction is granted only when a satisfactory program for elimination is in place. Furthermore, approval, when granted, is for a temporary period normally with a fixed terminal date.

The present approval status of payments arrears maintained by Fund members is summarized in Table 4. The existence of payments arrears as an exchange restriction was noted in all of the staff reports for the relevant Article IV consultations or on requests for the use of Fund resources. In the Executive Board decisions relating to their maintenance as an exchange restriction, approval was granted in 11 instances during 1980-82--all on a temporary basis with a terminal date--and, with the exception of one case (The Gambia), approval was granted on the basis of a program which incorporated a reduction in payments arrears as a performance criterion. 2/ In all instances of approval involving members with stand-by or extended arrangements in effect in November 1982, the performance criterion with respect to payments arrears required a substantial reduction during the first year of the program. In 14 cases where the payments arrears were recognized as constituting an exchange restriction involving current payments, approval was not proposed by the staff normally because of the lack of a meaningful program to reduce the level of payments arrears or the programmed reduction was considered inadequate. A substantial reduction in the level of payments arrears has therefore been a prerequisite for approval by the Executive Board under Article VIII of the Fund's Articles. In no instances has approval for the maintenance of payments arrears been granted for members which had entered into a standby or an extended arrangement and where the arrangement had become inoperative due to the nonobservance of a performance criterion, including that relating to payments arrears.

V. Summary

External payments arrears and defaults are incurred, generally speaking, when other measures to correct an unsustainable balance of payments position have not been adopted soon enough, or are of insufficient strength. Other possible measures aimed at keeping payments current include the imposition of exchange and trade restrictions as temporary expedients, while rescheduling of the obligations takes place and additional adjustment measures are brought

1/ See footnote 1/, page 1.

2/ The Gambia's payments arrears were approved on a temporary basis while the negotiation of a program was in progress. Shortly afterwards, The Gambia entered into a one-year stand-by arrangement that included a phased reduction of payments arrears.

Table 4. Treatment of Payments Arrears In Executive Board Decisions, 1980-1982 1/

	Year of Executive Board consideration of exchange system	Recognition of payments arrears as exchange restriction	Fund approval 2/ at time of Executive Board consideration
Argentina 3/	1982	No 4/	...
Benin	1981	No 5/	...
Bolivia 3/	1982	Yes	No 6/
Chad	1979	No 5/	...
Comoros	1981	No 4/	...
Congo, People's Republic	1982	No 5/	...
Costa Rica 3/	1982	Yes	Yes 7/
Dominican Republic 3/	1981	Yes	No
El Salvador 3/	1982	Yes	Yes 7/
Gambia	1981	Yes	Yes 7/
Ghana	1980	Yes	No
Guinea	1981	Yes	No
Guinea-Bissau	1979	Yes	No
Guyana 3/	1982	Yes	No
Haiti 3/	1981	Yes	Yes 7/
Honduras 3/	1982	Yes	No
Jamaica 3/	1981	Yes	Yes 7/
Liberia	1981	Yes	Yes 7/
Madagascar	1982	Yes	Yes 7/
Mali	1981	No 5/	...
Mauritania	1980	Yes	No
Nicaragua 3/	1981	Yes	No
Romania	1982	Yes	Yes 7/
Sierra Leone	1982	Yes	No
Somalia	1981	Yes	No
Sudan	1982	Yes	No
Tanzania	1982	Yes	No
Togo	1981	No 5/	...
Turkey	1982	Yes	No
Uganda	1980	Yes	Yes 7/
Viet Nam	1982	Yes	No
Western Samoa	1980	No 8/	...
Zaire	1982	Yes	Yes 7/
Zambia	1981	Yes	Yes 7/

Sources: Staff reports for Article IV consultation discussions or Executive Board papers dealing with payments arrears of countries concerned.

1/ Refers to the most recent year of Article IV consultation decisions or special Executive Board papers dealing with payments arrears when the country was known to have had payments arrears during the period through November 30, 1982. In instances in which Executive Board decisions were not adopted since 1980, the record of the most recent decision is shown. All recent approvals shown in the table, with the exception of one case, were granted under the Article IV consultation decisions or special Executive Board decisions.

2/ No members maintained external payments arrears under the provisions of Article XIV of the Fund's Articles.

3/ Member has assumed obligations under Article VIII of the Fund's Articles of Agreement.

4/ Payments arrears emerged after the conclusion of the Article IV consultation.

5/ Payments arrears were treated as defaults and were therefore not considered to constitute an exchange restriction subject to Article VIII.

6/ Proposed treatment; Executive Board discussion had not yet taken place as of November 30, 1982.

7/ Approval was granted on a temporary basis (with a terminal date).

8/ Payments arrears were known to exist after the conclusion of the Article IV Consultation.

to bear. The problems posed by external payments arrears have intensified sharply in 1982. Not only have aggregate arrears nearly trebled in a short period, but there has been an increasing tendency for relatively more developed economies to incur arrears as these have tended to gravitate from the African region to Eastern Europe and Latin America. An increase in arrears raises the riskiness of international lending. One consequence is that countries in arrears are accorded reduced access to international capital markets. A second consequence is that the cost of international credit becomes higher than would otherwise be the case for most borrowers.

Performance criteria for the elimination or substantial reduction of external payments arrears constitute an important element of Fund programs with countries in arrears. Being directed toward the normalization of creditor relations and thus "unlocking" credits, Fund resources, in the context of meaningful adjustment programs, play an important role in restoring the member's access to international credits at a sustainable level of real resource inflows. Where there is no program in effect with the Fund, the incurrence of arrears and related policies have been subject to careful scrutiny in the context of Article IV consultations with the Fund. In many instances, a counterpart deposit requirement not only will demonstrate the authorities' determination to reduce and eventually eliminate payments arrears, but also will facilitate the process of payments arrears reduction in an orderly manner. In this connection, it may be noted that a number of existing stand-by or extended facility programs provide for the counterpart deposit requirement; the staff is continuing its efforts in this area, and several recently formulated programs have included such a provision.

In view of the disorderly nature of this form of exchange restriction which makes it particularly undesirable, the staff has consistently followed the practice of not recommending approval for the maintenance of arrears with respect to current international payments under Article VIII of the Fund's Articles except when a satisfactory program for their elimination has been in place. Such a program may be in support of the use of Fund resources by the member or, in instances in which use of Fund resources is not appropriate, the schedule for elimination may be incorporated in the framework of policy discussions with the member at the time of its Article IV consultation with the Fund.

In a number of instances, arrears of members have represented defaults by governments participating in common central bank arrangements that resulted from the government's inability to obtain domestic currency with which to purchase needed foreign exchange from the common central bank. Although the distinction between these and other such arrears is relevant for the purpose of Articles VIII and XIV, in the context of the Fund's policies relating to consultation under Article IV, defaults and other forms of arrears involving current and capital payments are viewed as having the same broad macroeconomic character and consequences, and are therefore treated in the same manner.

The staff has been continuing its efforts to improve the quality of the data on payments arrears incurred by member countries, and some improvements have been evident. However, in a number of countries the quality of data

relating to payments arrears is still poor, not only with respect to the total amount but also with respect to the type of payments arrears. If programs for the reduction of payments arrears are to contribute to a country's balance of payments and adjustment process, they must be based on sound and comprehensive information regarding the profiles of payments arrears and be coordinated with external debt and reserve management.

Payments arrears involve continuous flows of exchange transactions, so that their restrictiveness may change frequently. However, the data on external payments arrears are available for most countries on a lagged basis only. Timely information on rescheduling of arrears and flows of cash payments would permit the estimation of arrears changes, but these data (particularly the cash payments) are also incomplete. The improvements in the quality of information being sought in this area are important for monitoring the progress being made in the liberalization of arrears.

Table I. Payments Delayed and Deferred by Non-Oil Developing Countries, in Relation to Imports and Debt, 1975-82

	1975	1976	1977	1978	1979	1980	1981	1982
(In millions of U.S. dollars)								
a. Arrears	990	2,037	6,244	6,500	7,338	6,783	7,135	19,851
b. Rescheduling <u>1/</u>	458	386	534	2,782	5,765	4,905	2,232	6,100
c. Cumulative net amounts due and rescheduled <u>2/</u>	4,494	4,680	4,705	7,139	13,708	18,155	19,864	34,162 <u>3/</u>
d. Imports of non-oil developing countries	153,000	160,400	191,900	227,800	298,000	387,700	402,100	426,100
e. Outstanding public and publicly-guaranteed debt of non-oil developing countries	146,800	181,400	221,800	276,400	324,400	375,400	436,900	505,200
(In per cent)								
Memorandum items:								
a/d	0.6	1.3	3.3	2.9	2.5	1.8	1.8	4.7
a/e	0.7	1.1	2.8	2.4	2.3	1.8	1.6	3.9
b/d	0.3	0.3	0.3	1.2	1.9	1.3	0.6	1.4
b/e	0.3	0.2	0.2	1.0	1.8	1.3	0.5	1.2
(a + c)/d	3.6	4.2	5.7	6.0	7.1	6.4	6.7	12.7
(a + c)/e	3.7	3.7	4.9	4.9	6.5	6.4	6.2	10.7

Sources: IBRD, World Debt Tables; OECD, External Debt of Developing Countries; IMF, IFS; and staff estimates.

1/ Amounts rescheduled in each year are with respect to ODA countries and major private creditors.

2/ Arrears and outstanding amounts rescheduled, net of estimated payments in respect of rescheduled amounts.

3/ Includes Mexican public sector and nationalized bank debt subject to 90-day rollover from August 23, 1982 (recently extended by 120 days).



Office Memorandum

TO : The Managing Director
The Deputy Managing Director

DATE: January 4, 1983

FROM : C. David Finch *CD*

SUBJECT : External Payments Arrears of Fund Members, 1981-82

A draft paper on the abovementioned subject has been prepared for information of the Executive Board. The paper responds to the request, made by a number of Directors at the time of the Board's 1980 review of the Fund's policies and procedures in this area, that information on payments arrears would be compiled and circulated regularly with the aim also of improving the consistency and comprehensiveness of this important data. The present paper, which covers the period through the third quarter of 1982, updates a paper issued earlier this year (EBS/82/57, 3/31/82) that dealt with the period through the third quarter of 1981. The paper represents a bringing together, with the assistance of the area departments, of comprehensive material on arrears available within the Fund at this time. It has been cleared with the area, Legal, and Research Departments.

In summary, the paper reviews the available information on Fund members' arrears and their relationships with other means of deferring payments obligations, particularly rescheduling; examines steps taken by member countries to identify and eliminate this particularly damaging form of irregularity in their international relations; and places these issues in the context of the Fund's policies in the use of its resources, and also under Article VIII, given that arrears usually represent an exchange restriction within the Fund's jurisdiction. A point brought out by the paper is that performance criteria for the reduction of known arrears have been incorporated in all Fund programs now in effect with such members.

For your approval please.

Attachment

cc: Heads of Departments:
AFR, ASD, EUR, LEG, MED, RES, WHD
Mr. Carter



MANAGING DIRECTOR



INTERNATIONAL MONETARY FUND
WASHINGTON, D. C. 20431

CC: EUR
LEG

Mr. Karasa - Hasan
Mr. Quirk

CABLE ADDRESS
INTERFUND

November 20, 1982

Dear Mr. du Couëdic:

Thank you for your letter of October 19, 1982 informing me of the difficulties the International Electrotechnical Commission is experiencing due to delayed payments of contributions by some of its members. I share your concern about delays in international payments, a problem which the Fund, in its contacts with member governments, regards as a serious impediment to orderly international relations. The Fund has a jurisdictional function in such matters where the payments arrears are the result of governmental action to restrict the availability of foreign exchange. Through its close contacts with members, especially when providing financial assistance to them, the Fund has been helping them to formulate policies to reduce and eventually eliminate payments arrears on an orderly and nondiscriminatory basis. However, with the continuing difficult economic circumstances and the large balance of payments deficits of the developing countries, it is likely that some countries will require a considerable period of time before they can eliminate their payments arrears.

While the Fund has an active role in regard to the elimination of payments arrears, it is important for the Fund to avoid any action that would be viewed as favoring one creditor or group of creditors. With this in mind, may I suggest that the IEC take the matter up directly with the governments of those countries, where the national members are in payments arrears. We would, however, welcome information from the IEC on arrears in payments due to it from country units of Fund members. This information may be useful to us in dealing with the general problem of payments arrears.

Sincerely,

J. de Larosière

J. de Larosière

Mr. Michel du Couëdic
Secretary
French Electrotechnical Committee
12, Place des Etats-Unis
75783 Paris CEDEX 16
France.



Office Memorandum

ys
NDV 9 1982
DATE: November 8, 1982

TO : The Managing Director

FROM : C. David Finch *CF*

SUBJECT : Arrears in Contributions to International Electrotechnical Commission: Response to Mr. Couedic's letter

Attached for your approval is a letter from you to Mr. Couedic, the Secretary of the French Electrotechnical Committee. It responds to his enquiries concerning assistance from the Fund in ensuring the collection of overdue contributions from certain members of the International Electrotechnical Commission (IEC). The IEC is an international association of 44 national private and semi-governmental organizations (one per country) that was founded in 1966 with the aim of promoting international cooperation on all questions of electric and electronic standards. It is registered in Switzerland and headquartered in Geneva.

The questions raised by Mr. du Couedic are of obvious concern to the Fund, although the Fund's jurisdiction is involved in the arrears only insofar as they are due to delays and other restrictions imposed by countries on the making available of foreign exchange for payments and transfers for current international transactions. The point is made explicitly in the letter. Despite our interest in these matters, however, the status of the IEC as a voluntary private organization precludes any formal dialogue with the Fund. This would be fully consistent with the Fund's general approach in its dealings with nonofficial or nongovernmental entities--in particular, with the approach taken to similar representations to you in 1979 by the International Air Transport Association concerning payments delays. Nevertheless, the IEC may well have information pertaining to delays and other restrictions in individual Fund member countries that is not available to the Fund from other sources. Mr. du Couedic may be assured that such information could be helpful in assisting the Fund in implementing its general policies regarding the reduction and eventual elimination of arrears in member countries.

This has been cleared with Legal Department.

Attachment

cc: Deputy Managing Director, LEG, EUR, Mr. Carter

SEC-82/4749

Translated by I. Raynsford
Reviewed by M. T. Iordanow
480609

Paris, October 19, 1982

Mr. Jacques de Larosière
Managing Director
International Monetary Fund
Washington, DC 20431
U.S.A.

Sir:

I hope that the friendship shared by our daughters is a sufficient basis for me to request a service or advice of a professional nature.

I am Secretary of the French Electrotechnical Committee, a 1901 association, which is the French member of the International Electrotechnical Commission (IEC), with headquarters in Geneva. The IEC, whose aim is to promote international standardization, exerts considerable influence over developments with respect to trade in electrical and electronic equipment.

Because of the international crisis, the IEC is at present faced with financial difficulties (a deficit amounting to SwF 469,000 in 1981). To a considerable degree these difficulties stem from delayed payments of contributions by certain of its members (private or semigovernmental organizations)--in particular those most seriously affected by the crisis.

As these countries are doubtless those receiving the greatest amount of assistance from the International Monetary Fund, it occurred to me that some encouragement from the IMF might be an effective means of ensuring the collection of these overdue contributions.

If you see any possibility for such action or any other means of improving the financial situation of an international organization affected by the present crisis, I should be most grateful if you could let me know. Once I hear from you, I will inform the IEC Treasurer, who, at the present time, is a French national.

Very truly yours,

/s/

Michel du Couëdic

Michel du Couëdic
Secretary
French Electrotechnical Committee
12, place des Etats-Unis
75783 PARIS CEDEX 16

480609

THE ORIGINAL IS BEING TRANSLATED

480609

PARIS, le 19 octobre 1982

ORIG: EXR
CC: MD
DMD
EUR
MR.N.CARTER

Mr. Palumbo
What should I
remember
similar in the
from air company
2 years ago.
over 27 n

Monsieur Jacques de LAROSIERE
Directeur Général du
Fonds Monétaire International
WASHINGTON, DC 20431
Etats-Unis

RECEIVED
INTERNATIONAL
MONETARY FUND

1982 OCT 26 PM 4:39

COMMUNICATIONS
DIVISION

Cher Monsieur,

Permettez moi de me recommander de l'amitié qui unit nos filles pour vous demander un service ou un conseil, de caractère professionnel.

Je suis secrétaire du Comité Electrotechnique Français, une association 1901, qui est le membre français de la Commission Electrotechnique Internationale (CEI) dont le siège est à Genève. La CEI, qui a pour vocation la normalisation internationale, a une influence certaine sur le développement des échanges commerciaux de matériels électriques.

La CEI est actuellement confrontée a des difficultés financières, dues à la crise mondiale (déficit de 469.000 Fr.S. en 1981). Ces difficultés proviennent pour une part importante de retards dans le paiement de cotisations de certains de ses membres (organismes privés ou paragouvernementaux) - surtout ceux les plus touchés par la crise.

Comme ces pays sont vraisemblablement ceux qui sont le plus aidés par le Fonds Monétaire International, j'ai pensé qu'une incitation du FMI pourrait être efficace pour assurer le recouvrement de ces cotisations en retard.

Au cas où vous verriez une possibilité d'action dans ce sens, ou tout autre moyen d'améliorer les finances d'une organisation internationale secouée par la crise, je vous serais extrêmement reconnaissant de me le faire savoir et j'en informerai alors le trésorier de la CEI, qui est actuellement un français.

Veuillez agréer, cher Monsieur, l'expression de mes sentiments les meilleurs.

Michel du Couëdic

Michel du Couëdic
Secrétaire du
Comité Electrotechnique Français



Office Memorandum

TO : The Managing Director

FROM : C. David Finch *CF*

SUBJECT : Arrears in Contributions to International Electrotechnical Commission: Response to Mr. Couedic's letter

DATE: November 8, 1982

Attached for your approval is a letter from you to Mr. Couedic, the Secretary of the French Electrotechnical Committee. It responds to his enquiries concerning assistance from the Fund in ensuring the collection of overdue contributions from certain members of the International Electrotechnical Commission (IEC). The IEC is an international association of 44 national private and semi-governmental organizations (one per country) that was founded in 1966 with the aim of promoting international cooperation on all questions of electric and electronic standards. It is registered in Switzerland and headquartered in Geneva.

The questions raised by Mr. du Couedic are of obvious concern to the Fund, although the Fund's jurisdiction is involved in the arrears only insofar as they are due to delays and other restrictions imposed by countries on the making available of foreign exchange for payments and transfers for current international transactions. The point is made explicitly in the letter. Despite our interest in these matters, however, the status of the IEC as a voluntary private organization precludes any formal dialogue with the Fund. This would be fully consistent with the Fund's general approach in its dealings with nonofficial or nongovernmental entities--in particular, with the approach taken to similar representations to you in 1979 by the International Air Transport Association concerning payments delays. Nevertheless, the IEC may well have information pertaining to delays and other restrictions in individual Fund member countries that is not available to the Fund from other sources. Mr. du Couedic may be assured that such information could be helpful in assisting the Fund in implementing its general policies regarding the reduction and eventual elimination of arrears in member countries.

This has been cleared with Legal Department.

Attachment

cc: Deputy Managing Director, LEG, EUR, Mr. Carter

DRAFT

November 8, 1982

Dear Mr. du Couedic:

Thank you for your letter of October 19, 1982 informing me of the difficulties the International Electrotechnical Commission is experiencing due to delayed payments of contributions by some of its members. I share your concern about delays in international payments delays, a problem which the Fund, in its contacts with member governments, regards as a serious impediment to orderly international relations. The Fund has a jurisdictional function in such matters where the payments arrears are the result of governmental action to restrict the availability of foreign exchange. Through its close contacts with members, especially when providing financial assistance to them, the Fund has been helping them to formulate policies to reduce and eventually eliminate payments arrears in an orderly and nondiscriminatory basis. However, with the continuing difficult economic circumstances and the large balance of payments deficits of the developing countries, it is likely that some countries will require a considerable period of time before they can eliminate their payments arrears.

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Sincerely,

J. de Larosiere

Mr. Michel du Couedic
Secretary
French Electrotechnical Committee
12, place des Etats-Unis
75783 Paris CEDEX 16

SEC-82/4749

Translated by I. Raynsford
Reviewed by M. T. Iordanow
480609

Paris, October 19, 1982

Mr. Jacques de Larosière
Managing Director
International Monetary Fund
Washington, DC 20431
U.S.A.

Sir:

I hope that the friendship shared by our daughters is a sufficient basis for me to request a service or advice of a professional nature.

I am Secretary of the French Electrotechnical Committee, a 1901 association, which is the French member of the International Electrotechnical Commission (IEC), with headquarters in Geneva. The IEC, whose aim is to promote international standardization, exerts considerable influence over developments with respect to trade in electrical and electronic equipment.

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As these countries are doubtless those receiving the greatest amount of assistance from the International Monetary Fund, it occurred to me that some encouragement from the IMF might be an effective means of ensuring the collection of these overdue contributions.

If you see any possibility for such action or any other means of improving the financial situation of an international organization affected by the present crisis, I should be most grateful if you could let me know. Once I hear from you, I will inform the IEC Treasurer, who, at the present time, is a French national.

Very truly yours,

/s/

Michel du Couëdic

Michel du Couëdic
Secretary
French Electrotechnical Committee
12, place des Etats-Unis
75783 PARIS CEDEX 16

Mr. Finch

Handwritten mark

INTERNATIONAL MONETARY FUND

November 1, 1982

Mr. Kanesa-Thanan:

The Managing Director sent us the attached letter of October 19 from the Secretary of the French Electrotechnical Committee. At my request, Peter Quirk has prepared proposed draft replies. Please take IO responsibility for reviewing this matter, clearing the drafts with other departments, and having the final text prepared for Mr. Finch's approval.

Attachments

DM

cc: Messrs. Finch, Quirk

Donald K. Palmer

INTERNATIONAL MONETARY FUND

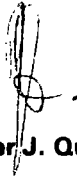
November 1, 1982

Mr. Palmer:

Attached are drafts of a letter from the Managing Director responding to the enquiry re arrears with the International Electrotechnical Commission (IEC) and a cover note. A copy of the translated incoming letter is attached for your information.

The drafts have not yet been cleared with other departments, as I thought you might wish to review them first.

Attachments



Peter J. Quirk

DRAFT
PJQuirk:jg
November 1, 1982

Dear Mr. du Couedic:

Thank you for your letter of October 19, 1982 informing me of the difficulties the International Electrotechnical Commission is experiencing owing to delayed payments of contributions by some of its members. I share your concern with the problem of international payments delays--a problem which the Fund, in its contacts with member governments, addresses as a serious impediment to orderly international relations. The Fund watches closely the problem of payments arrears in some of its member countries, and assists members in the formulation of policies to reduce and eventually eliminate arrears. The Executive Board of the Fund, in fact, has only recently reviewed its policies and procedures in this general area. However, with the continuing difficult economic circumstances and the large balance of payments deficits of the developing countries, our expectation is that the arrears situation will remain difficult for some time.

While the Fund is interested in obtaining any available information on payments delays in its member countries, your suggestion that the Fund take up with the countries in arrears the specific matter of resident private, or semigovernmental organizations' overdue contributions to the IEC may be achieved through the Fund's usual procedures for these matters. The Fund's dealings with its members are, as you may be aware, at the governmental level and the information upon which the Fund takes official action is communicated, or confirmed, to the Fund through official channels from member governments. The reason for this precaution is, in part, the need for the Fund to avoid taking a course of action that might be viewed as discriminatory intervention on behalf of any one creditor or group of

creditors. With this in mind, may I suggest that the IEC take the matter up with the authorities of the respective members of the Fund in which one or more of the national committees of the IEC are incorporated or have their legal domicile. These governments could bring the matter to the Fund directly or through the IMF Executive Directors elected or appointed by these member countries in the Fund, and the matter would then be dealt with by Fund staff in their contacts with the country concerned. In the meantime, we would be pleased to receive any information you might wish to provide as to the specific countries in which delays have arisen, so as to aid us in identifying the existence of any general arrears problem in a country in the event that this has not already been identified, and seeking its solution.

Sincerely,

J. de Larosiere

Mr. Michel du Couedic
Secretary
French Electrotechnical Committee
12, place des Etats-Unis
75783 PARIS CEDEX 16

The Managing Director

November 1, 1982

~~Donald K. Palmer~~ C. David Fine

Arrears in Contributions to International Electrotechnical
Commission: Response to Mr. Couedic's letter

Attached for your approval is a letter from you to Mr. Couedic, the Secretary of the French Electrotechnical Committee. It responds to his enquiries concerning assistance from the Fund in ensuring the collection of overdue contributions from certain members of the International Electrotechnical Commission (IEC). The IEC is an international association of 44 national private and semigovernmental organizations (one per country) that was founded in 1966 with the aim of promoting international cooperation on all questions of electric and electronic standards. It is registered in Switzerland and headquartered in Geneva.

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This has been cleared with Legal and European Departments.

cc: Deputy Managing Director, LEG, EUR, Mr. Carter

REC. 10/29

SEC-82/4749

Translated by I. Raynsford
Reviewed by M. T. Iordanow
480609

Paris, October 19, 1982

Mr. Jacques de Larosière
Managing Director
International Monetary Fund
Washington, DC 20431
U.S.A.

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Very truly yours,

/s/

Michel du Couëdic

Michel du Couëdic
Secretary
French Electrotechnical Committee
12, place des Etats-Unis
75783 PARIS CEDEX 16

INTERNATIONAL MONETARY FUND


August 20, 1982

Mr. Carter:

In response to the Managing Director's request, the attached tables give data on arrears of debt related to total debt outstanding, including historical data. Please let me know if you require the data in some other format.

Attachment

cc: Mr. Finch ✓

Eduard H. Brau 

August 20, 1982

External Arrears: Explanatory Note

The attached data relate the level of external arrears to the stock of outstanding debt for those countries which recorded arrears during the period 1976-82 (Table 2). Due to data limitations, it has not been possible to present, as requested, a comprehensive survey of arrears incurred on debt service commitments only. Consequently, the total arrears position has also been included. This may provide a comprehensive approximation of the underlying debt (or balance of payments) problem, in view of the fungibility of funds.

With reference to the attached tables, the following considerations should also be borne in mind:

1. The paucity of data has precluded inclusion of short-term official debt and debt contracted by the private sector.
2. A number of countries, which are indentified, participate in joint central bank arrangements and have accumulated arrears as a result of the governments' inability to obtain domestic currency. Since, in certain instances, it has not been possible to distinguish between domestic and external arrears, the total arrears position is shown.
3. Arrears data for 1982 is particularly limited and for the most part restricted to the early part of the year. The available data do, however, indicate continued arrears accumulation by several countries (notably Ghana, Guyana, Romania, and Sudan and, although no current data is available, also by Viet-Nam and Zaire). In addition, Argentina has reported arrears for the first time. On the other hand, Liberia and Turkey fully liquidated their arrears during the first half of the year.

Table 1. External Payments Arrears, 1976-82 1/

(End of period, in millions of U.S. dollars)

	External debt 2/	1976	1977	1978	1979		1980		1981		1982	
		Total Arrears	Total Arrears	Total Arrears	Total Arrears	Debt Arrears	Total Arrears	Debt Arrears	Total Arrears	Debt Arrears	Total Arrears	Debt Arrears
Argentina	21,279 3/	--	--	--	--	--	--	--	--	--	2,310 3/	1,052 3/
Benin	417 4/	...	...	...	29	...	27	...	--	--	--	--
Bolivia	2,124 5/	--	--	--	55	...	189	...	93	51	...	...
C.A.R. *	213 4/	41	47	10	55	...	80	...	--	--	--	--
Chad *	159 5/	10	11	29	51	...	66	...	...	...	...	...
Congo *	898 5/	30	53	87	66	...	28	--	...	...	...	...
Costa Rica	1,974 4/	--	--	--	--	--	283	--	658	405	...	...
Dominican Rep.	1,186 5/	3	--	--	22	...	147	...	312	...	...	...
Egypt	13,054 5/	363	1,047	--	--	--	--	--	--	--	--	--
El Salvador	509 5/	--	--	--	--	--	52	4	78	5	...	...
Gabon	998 4/	--	41	34	--	--	--	--	--	--	--	--
The Gambia	86 4/	--	522	442	--	--	13	--	20	--	...	...
Ghana	1,011 5/	223	244	512	427	68	332	53	485	63	565 3/	68 3/
Grenada *	7 6/	--	--	3	1 10/	...	--	--	--	--	--	--
Guinea	1,255 4/	105	145	197	223	...	121	...	107	...	144	...
Guinea-Bissau	34 6/	8	9	10	7	...	9	...	...	...	...	...
Guyana	633 4/	--	33	22	26	--	29	--	46	--	74 3/	-- 3/
Haiti	295 4/	--	--	--	--	--	22	...	...	...	...	...
Jamaica	1,761 7/	--	27	63	55	...	113	38	48	16	...	...
Liberia	575 3/	--	--	--	--	--	--	--	7	...	--	--
Madagascar	1,215 4/	6	9	14	17	--	185	17	125	...	166 8/	...
Mali	621 5/	--	13	23	36	5	48	13	51	17	...	...
Mauritania	714 5/	--	11	30	20	20	19	19	23	23	...	...
Nicaragua	2,199 4/	--	--	76	478	478	240	240	58	58	...	...
Peru	6,909 4/	...	...	150	--	--	--	--	--	--	--	--
Romania 9/	10,160 4/9/	--	--	--	--	--	--	--	1,142	503	2,853 7/	1,973 7/
Senegal *	906 5/	...	...	...	...	...	9	9	11	11	...	...
Sierra Leone	381 4/	10	15	22	71	20	97	--	30	30	...	...
Somalia	760 4/	--	--	--	17	17	45	45	16	16	8 10/	8 10/
Sudan	7,015 3/	280	695	778	1,156	...	1,378	...	1,099	...	1,740 3/11/	...
Tanzania	1,355 5/	--	--	65	155	--	303	--	260	--	...	...
Togo *	861 4/	--	19	56	65	65	28	28	69	69	...	...
Turkey	15,433 5/	235	2,077	1,984	2,330	186	1,614	48	320	--	--	--
Uganda	579 10/	45	26	89	90	65	213	125	133	112	123 3/	103 3/
Viet Nam	1,289 4 9/	--	--	--	--	--	--	--	38	38	...	...
Zaire	4,320 4/	448	815	1,238	1,472	853	533	--	498	175	...	...
Zambia	1,969 4/	259	479	646	462	--	588	--	581	--	504 8/	-- 8/
Total 12/		2,075	6,297	6,546	7,386		6,818		6,308			

Source: Country authorities; staff estimates; and World Bank Debt Tables.

See attachment for footnotes.

Attachment to Table 1

Footnotes

- 1/ Debt arrears refer to arrears on principal and interest payments.
- 2/ Medium- and long-term public and publicly-guaranteed debt (disbursed), as of most recent date available.
- 3/ End-June 1982.
- 4/ End-1981.
- 5/ End-1980.
- 6/ End-1978.
- 7/ End-April 1982.
- 8/ End-February 1982.
- 9/ In convertible currencies.
- 10/ End-March 1982.
- 11/ Data break due to reassessment of debt statistics.
- 12/ Totals for all years except 1980 may underestimate the actual amounts outstanding due to the non-availability of data for certain countries. For this reason, no totals have been given for debt arrears or for total arrears for 1982.

Symbols

- * Members of common central bank arrangements; arrears result from lack of domestic currency counterpart; data may include domestic arrears.
- ... Data unavailable.
- No arrears outstanding.

Table 2. External Payments Arrears, 1976-82 1/

(End of period, as percentages of external debt) 2/

	1976	1977	1978	1979		1980		1981		1982	
	Total Arrears	Total Arrears	Total Arrears	Total Arrears	Debt Arrears	Total Arrears	Debt Arrears	Total Arrears	Debt Arrears	Total Arrears	Debt Arrears
Argentina	--	--	--	--	--	--	--	--	--	11 3/	5 3/
Benin *	...	...	...	15	...	10	...	--	--	--	--
Bolivia	--	--	--	3	...	9	...	4 4/	2 4/	...	...
C.A.R. *	46	41	8	38	...	39	...	--	--	...	...
Chad *	11	9	18	30	...	42	...	...	...	...	...
Congo *	7	11	11	8	...	3	--	...	...	...	...
Costa Rica	--	--	--	--	--	18	--	33	21	...	...
Dominican Rep.	3	--	--	3	...	12	...	26 4/	...	...	...
Egypt	6	13	--	--	--	--	--	--	--	--	--
El Salvador	--	--	--	--	--	10	1	15 4/	1 4/	...	...
Gabon *	--	41	34	--	--	--	--	--	--	...	...
The Gambia	--	--	--	--	--	19	--	23	--	...	...
Ghana	33	30	60	44	7	33	5	48 4/	6 4/	56 5/	7 5/
Grenada *	--	--	43	14 5/	...	--	--	--	--	--	--
Guinea	13	17	21	23	...	10	...	11	...	...	...
Guinea-Bissau	50	39	29	...	...	...	...	...	...	...	...
Guyana	--	8	5	5	--	5	--	7 3/	--	12 3/	-- 3/
Haiti	--	--	--	--	--	7	...	...	...	...	...
Jamaica	--	3	6	5	...	9	3	3 7/	1 7/	...	...
Liberia	--	--	--	--	--	--	--	1 4/	...	...	...
Madagascar	3	4	5	3	--	18	2	10	--	14 8/	...
Mali	--	3	4	7	1	8	2	8 4/	3 4/	...	...
Mauritania	--	4	5	3	3	3	3	3 4/	3 4/	...	...
Nicaragua	--	--	8	43	43	16	16	3	3	...	...
Peru	...	3	--	--	--	--	--	--	--	--	--
Romania 9/	--	--	--	--	--	--	--	11	5	27 10/	19 10/
Senegal *	...	...	...	...	...	1	1	1 4/	1 4/	...	...
Sierra Leone	6	8	9	25	7	27	--	8	8	...	...
Somalia	--	--	--	3	3	7	7	2	2	1 11/	1 11/
Sudan	18	39	38	45	...	44	...	35 4/	...	25 12/13/...	...
Tanzania	--	--	6	13	--	22	--	20 4/	--	...	...
Togo *	--	6	9	8	8	3	3	8	8	...	...
Turkey	7	49	32	21	2	12	--	2	--	-- 11/	-- 11/
Uganda	20	10	27	19	14	38	22	25	21	21 14/	18 14/
Viet Nam 9/	--	--	--	--	--	--	--	2 15/16/	2 15/16/...	...	...
Zaire	20	28	34	35	20	13	--	12	4	...	...
Zambia	13	34	45	29	--	32	--	30	--	26 8/	-- 8/

Source: Country authorities; staff estimates; and World Bank Debt Tables.

See attachment for footnotes.

Attachment to Table 2

Footnotes

- 1/ Debt arrears refer to arrears on principal and interest payments.
- 2/ Medium- and long-term public and publicly-guaranteed debt (disbursed)
- 3/ End-June 1982 arrears as a percentage of end-1981 external debt.
- 4/ As a percentage of end-1980 external debt.
- 5/ End-June 1982 arrears as a percentage of end-1980 external debt.
- 6/ As a percentage of end-1978 external debt.
- 7/ As a percentage of end-April 1982 external debt.
- 8/ End-February 1982 arrears as a percentage of end-1981 external debt.
- 9/ As a percentage of external debt in convertible currencies.
- 10/ End-April 1982 arrears as a percentage of end-1981 external debt.
- 11/ End-March 1982 arrears as a percentage of end-1981 external debt.
- 12/ End-June 1982.
- 13/ Data break due to reassessment of debt statistics.
- 14/ End-June 1982 arrears as a percentage of end-March 1982 external debt.
- 15/ As a percentage of debt in convertible currencies.
- 16/ Excludes arrears to Fund; see EBS/82/142.

Symbols

- * Members of common central bank arrangements; arrears result from lack of domestic currency counterpart; data may include domestic arrears.
- ... Data unavailable
- No arrears outstanding



Office Memorandum

Mr. Finch

TO : ETR Economists

FROM : C. David Finch *SDM for CDF*

SUBJECT : Information on External Payments Arrears

DATE: August 31, 1982

Towards the end of 1981 you assisted in the preparation of a paper compiling available information on external payments arrears (EBS/82/57) which was in response to the Executive Board's request for regular reporting in this important area. We now plan to update this information for the purpose of commencing regular issuance of the report.

Those economists whose assigned countries are listed in Table 1 appended to the attached questionnaire should proceed directly to compiling the required information (for assignments see Attachment 2). Other economists whose countries are not listed in Table 1 should check for the emergence of arrears in their countries since preparation of the last report and for the existence of previously undetected arrears. In preparing responses to the questionnaire, the emphasis is on new information--the last report noted that the staff would be continuing its efforts to improve information on arrears, particularly in the following respects:

1. The basis of the arrears numbers (from the due date or with allowance for "normal" delays);
2. Types of arrears, especially with respect to debt service payments (as per question 1 of the questionnaire);
3. Data relating to methods of arrears reduction (cash payments against arrears, rescheduling of arrears, and newly incurred arrears).

If after careful consideration it is clear that no new information is available in response to a particular item in the questionnaire, then this should simply be noted without repeating the earlier response. ^{1/} The responses to the questionnaire, should be prepared with the full involvement of the responsible mission head or area department division chief, who has been advised that you will contact him.

Additions of countries to Table 1 should be advised by September 3, and country data and notes for these and for the other countries having arrears are needed by September 17--please address these and any questions you may have to Mr. Huh. Issuance of the updated report is scheduled for October.

Attachments

cc: Immediate Office
Division chiefs

^{1/} A copy of the previous questionnaire response for the assigned country is attached for your reference. Please note that the present questionnaire has been revised in certain respects.

Questions on Payments Arrears 1/

Country: _____

I. Amount and Type of Payments Arrears (Defaults)

1. Please provide data on payments arrears and defaults as per the following table (please refer to Appendix Table 1 and revise any data as necessary). Where possible, please provide data on external payments arrears and defaults (or domestic arrears) separately. 2/

	<u>(End of period; in millions of SDRs)</u>						
							1982
	1976	1977	1978	1979	1980	1981	(most recent month)
Arrears (defaults) with respect to:							
(i) Import payments, (of which: letters of credit)							
(ii) Invisibles payments, excluding interest payments on external debt							
(iii) External debt service payments, of which:							
(a) interest payments							
(b) amortization							
(iv) Capital account, excluding amortization of external debt							
(a) short term							
(b) long term							
Total							

1/ Country notes for all countries incurring payments arrears in any part of the period shown in the table under I.1 (i.e., during 1976-82) should address each of the questions, to the extent that they are applicable to the country concerned. If information required to answer a particular question is not available, this should be so indicated in the note. If information is not available in the precise form requested, please approximate it as closely as possible.

2/ Payments arrears constitute an exchange restriction when the authorities of a country are responsible for undue delays in approving applications or in meeting bona fide requests for foreign exchange for payments for imports, for other current international transactions, or for normal short-term banking transactions (including normal amounts for foreign loan amortization). When a government or a government entity whose financial operations form part of the budgetary process fails to meet an external payments obligation, the resulting arrears are treated as defaults rather than as external payments arrears. Similarly, payments arrears incurred by

2. Are these data based on staff estimates, using the staff's own definitional criteria, information provided by the authorities on the basis of their own criteria, and/or information from creditors or export credit agencies? Are the arrears measured from the due date, or taking into account "normal" processing delays? How reliable are these data? Have any problems been experienced in applying the definition of arrears to particular country cases?
3. Please describe any problems encountered in maintaining up-to-date information, steps being taken to remedy them, and improvements made in the compilation of data since the last survey.

II. Definition of Payments Arrears

1. Please describe the changes since the last survey in the nature of the governmental limitation on, or interference with, the availability of foreign exchange when payments are due (e.g., queuing procedures, compulsory waiting period, informal or ad hoc delays).
2. Please describe the changes since the last survey in the nature of payments arrears (e.g., the average length of delays involved in the approval of foreign exchange applications, the basis on which the delay has been judged "unreasonably long" taking into account the normal processing lag for exchange transactions, and the relative seriousness of "permanent" versus "temporary" delays).
3. Please describe counterpart deposits in domestic currency that are collected against foreign exchange applications (e.g., percentage of deposits; whether or not the deposits are held with the central bank or subject to a reserve requirement when held with a commercial bank; whether or not interest is paid on the deposits; the retention period of the deposits; whether or not the deposits are subject to exchange rate guarantees; and under stabilization programs supported by the use of Fund resources whether or not the deposits are adjusted for in the computation of domestic credit ceilings). Has the Fund staff recommended a deposit requirement? If so, which of the above features were recommended?

III. Causes and Effects of Payments Arrears

1. In order to provide a background for assessing the importance of developments in payments arrears, the following information would be appreciated:

2/ (continued) governments participating in a common central bank (e.g., BEAC, BCEAO, ECCA) are treated as defaults (or domestic arrears) when they result from the government's inability to obtain domestic currency with which to purchase needed foreign exchange from the common central bank. Defaults and domestic arrears are not treated as an exchange restriction under Article VIII.

(In millions of SDRs)
1981 1982

Projected 1/

- (i) Gross official reserves (end of period)
- (ii) Debt service payments
 - (a) Interest payments
 - (b) Amortization
- (iii) Exports f.o.b.
- (iv) Imports f.o.b. or c.i.f.
- (v) Current account balance (including official transfers)

2. What evidence, if any, is there that as a result of payments arrears the country's creditworthiness has suffered significantly, e.g., its ability to obtain trade credits and/or long-term loans, or to import on internationally competitive terms?

IV. Elimination of Payments Arrears and Defaults

1. Did the country reduce its payments arrears (and defaults) during 1981 and 1982? If so, (i) how much was reduced through cash payments, (ii) how much was reduced through rescheduling, and (iii) how much remained outstanding?
2. What was the role of the Fund in the reduction of payments arrears, e.g., (i) was a stand-by or an EFF program in effect; (ii) was a total/phased reduction of outstanding payments arrears included as a performance criterion; (iii) what were the amounts of reduction and on what basis were they determined; (iv) was the performance criterion observed, or if not, was it modified or waived; (v) were drawings interrupted either due to a failure to meet payments arrears reduction targets or to observe the standard clause regarding introduction/intensification of exchange restrictions, including new payments arrears?
3. When payments arrears were reduced through rescheduling: (i) Was it done in the framework of the Paris Club or bilaterally? (ii) Was the conclusion of a stand-by or an EFF arrangement with the Fund a precondition for the rescheduling? (iii) What portion of rescheduled debt represented payments arrears? (iv) In cases where a phased reduction of arrears was envisaged under a stand-by or an EFF program, did targets take into account, explicitly or otherwise, the anticipated rescheduling, or if rescheduling took place after the negotiation of the program, were rescheduled amounts adjusted subsequently as part of the phased reduction? (v) Did the country incur new payments arrears on rescheduled payments arrears?
4. In the attempt to eliminate or contain the growth of payments arrears, were other forms of trade or payments restrictions, including multiple currency practices, applied or intensified in 1982?

1/ Reserves data are for the most recent available month.

Appendix Table 1. External Payments Arrears Outstanding, 1975-1982 ^{1/}

(In millions of SDRs; end of period)

	1975	1976	1977	1978	1979	1980	1981 ^{2/}	1982 ^{2/}	1981 arrears as per-centage of:	
									1981 imports ^{2/}	Level of gross official international reserves ^{2/}
Argentina										
Benin	—	...	—	—	22	21	—	—	—	—
Bolivia	—	—	—	—	42	148 ^{3/}	80	—	—	—
Central African Rep.	...	35	39	8	42	63	—	—	—	—
Chad	9	9	9	22	39	52	...	...	...	...
Congo	13	26	44	67	50	22 ^{5/}	...	...	...	...
Costa Rica*	—	—	—	—	—	222	544 ^{4/}	—	—	—
Dominican Republic	—	11	—	—	17	37	72 ^{6/}	—	—	—
Egypt	82	312 ^{7/}	862 ^{8/}	—	—	—	—	—	—	—
El Salvador*	—	—	—	—	—	41	66 ^{4/}	—	—	—
Gabon*	—	—	430	339	—	—	—	—	—	—
The Gambia*	—	—	—	—	—	10	15 ^{6/}	—	—	—
Ghana	138	192	201	393	324	269	365 ^{6/}	—	—	—
Grenada	x	x	x	2	1	—	—	—	—	—
Guinea	136	90	119	151	169	95	...	...	...	...
Guinea-Bissau	2	7	7	8	5	7	...	...	...	...
Guyana	—	—	27	17	20	23	39 ^{9/}	—	—	—
Haiti*	—	—	—	—	—	—	26 ^{9/}	—	—	—
Honduras	—	—	—	—	—	—	10	—	—	—
Jamaica*	—	—	22	48	42	89	41 ^{9/}	—	—	—
Liberia*	—	—	—	—	—	—	6	—	—	—
Madagascar*	3	5	7	11	13	175	103	—	—	—
Mali*	—	—	11	18	27	38	54	—	—	—
Mauritania	—	x	9	23	15	15	20 ^{4/}	—	—	—
Nicaragua	—	—	—	58	363	188	50 ^{10/}	—	—	—
Peru*	—	...	...	115	—	—	—	—	—	—
Romania*	—	—	—	—	—	—	982 ^{10/}	—	—	—
Senegal*	...	...	...	...	...	7	12 ^{9/}	—	—	—
Sierra Leone	4	9	12	17	54	72	99	—	—	—
Somalia*	—	—	—	—	13	35	24	—	—	—
Sudan*	68	241	572	597	878	1,081	944 ^{12/}	—	—	—
Tanzania	—	—	—	50	118	238	226	—	—	—
Togo*	—	—	16	43	49	22	60	—	—	—
Turkey*	—	202	1,710	1,523	1,769	1,266	279 ^{6/}	—	—	—
Uganda*	37	39	21	70	75	178	114 ^{4/}	—	—	—
Viet Nam	—	—	—	—	—	—	33	—	—	—
Zaire	218	385	671	950	1,118	418	494	—	—	—
Zambia	136	223	394	496	351	461	500	—	—	—
Total	846	1,786	5,183	5,026	5,616	5,293	5,434	—	—	—

Sources: Country authorities; and staff estimates.

1/ The Table shows data on countries known to have had external payments arrears in any year during the period 1975-1982, or other dates indicated in the footnotes. Defaults, i.e., payments arrears incurred by governments participating in common central bank arrangements (Bank of Central African States (BEAC), Central Bank of West African States (BCEAO), and Eastern Caribbean Currency Authority (ECCA)) and which resulted from the government's inability to obtain domestic currency with which to purchase needed foreign exchange from the common central bank, as well as those incurred by the government or a government entity whose financial operations form part of the budgetary process, are included in these figures. In the former case, it was not possible to distinguish between domestic and external arrears; total arrears are shown.

2/ Latest estimates available in 1981 and 1982; total based on end-1980 figures, where 1981 figures not available.

3/ Includes SDR 135 million in payments arrears postponed by agreement with creditor banks through early 1981.

4/ December 1981.

5/ March 1980.

6/ October 1981.

7/ April 1976.

8/ April 1977.

9/ November 1981.

10/ Projection for 1981. The entire amount may not represent payments arrears as it is known to include delayed provision of foreign exchange due to administrative delays considered normal.

11/ As a ratio of convertible currency imports.

12/ June 1981.

Symbols:

* Financial program supported by use of Fund resources in effect in August 1982 (including inoperative arrangements).

x Arrears less than SDR 0.5 million.

Appendix Table 2. Fund Members Reported by International Agencies
as Incurring External Payments Delays in 1981 and 1982 1/

International Union of Credit and Investment Insurers (Berne Union) (as of June 30, 1982)		International Air Transport Association (IATA) (as of the most recent month in 1981)	
<u>Africa</u>			
Algeria	Malawi	Algeria	Morocco
Benin	Nigeria	Equatorial Guinea	Nigeria
Central African Republic	Senegal <u>2/</u>	Ethiopia	Sierra Leone <u>2/</u>
The Gambia <u>2/</u>	Sierra Leone <u>2/</u>	The Gambia <u>2/</u>	Somalia <u>2/</u>
Ghana <u>2/</u>	Tanzania <u>2/</u>	Ghana <u>2/</u>	Tanzania <u>2/</u>
Guinea <u>2/</u>	Togo <u>2/</u>	Guinea <u>2/</u>	Tunisia
Liberia <u>2/</u>	Uganda <u>2/</u>	Kenya	Uganda <u>2/</u>
Madagascar <u>2/</u>	Zaire <u>2/</u>	Madagascar <u>2/</u>	Zaire <u>2/</u>
	Zambia <u>2/</u>	Mauritania <u>2/</u>	Zambia <u>2/</u>
<u>Asia</u>			
Bangladesh	Viet Nam <u>2/</u>	Bangladesh	India
Kampuchea, Dem.	Lao, P.D. Rep.	Burma	Thailand
<u>Europe</u>			
Turkey <u>2/</u>		Greece	Spain
Romania <u>2/</u>		Portugal	Turkey <u>2/</u>
<u>Middle East</u>			
Libya		Egypt	Pakistan
Sudan <u>2/</u>		Iran	Sudan <u>2/</u>
Syria		Iraq	Syria
		Libya	Yemen, P.D.R.
<u>Western Hemisphere</u>			
Argentina	Guyana <u>2/</u>	Barbados	Guyana <u>2/</u>
Bolivia <u>2/</u>	Haiti <u>2/</u>	Brazil	Haiti <u>2/</u>
Costa Rica <u>2/</u>	Honduras <u>2/</u>	Colombia	Jamaica <u>2/</u>
Dominican Republic <u>2/</u>	Jamaica <u>2/</u>	Costa Rica <u>2/</u>	Nicaragua <u>2/</u>
Ecuador	Mexico	Dominican Republic <u>2/</u>	Trinidad & Tobago
El Salvador <u>2/</u>	Nicaragua <u>2/</u>	El Salvador <u>2/</u>	
Guatemala	Paraguay		

Sources: Confidential data provided to the Fund staff.

1/ The definitions of payments delays, as applied by these agencies, differ in a number of respects from the criteria for external payments arrears applied by the Fund for the purposes of Article VIII as set out in the body of this questionnaire. For this reason there is no presumption that these countries are in fact incurring external payments arrears constituting a restriction under Article VIII of the Fund's Articles of Agreement. Nevertheless, the two lists may serve as a basis for checking for the continued maintenance of, or the recent incurrence of, arrears by certain countries.

2/ Country has external payments arrears in 1981 and/or 1982 according to the Fund staff (but not necessarily with respect to remittances of airling earnings or with respect to obligations insured under Berne Union arrangements).

Country Assignments for 1981/82 1/

Abrams	Finland, Gambia, Iraq, Western Samoa
Abisourour	Central African Republic*, Mali*, Niger*, Togo, Upper Volta
Allen	China, Iran, Kampuchea
	Burma, Nigeria*, St. Lucia, United Arab Emirates
Belanger	Hungary, Israel, South Africa, Thailand
Berengaut	Barbados, Guatemala, Mauritania*, Tanzania, P.D.R. Yemen
Boonekamp	Ethiopia, Netherlands, Suriname, Zaire*
Dillon	Italy, Netherlands Antilles, Spain
Donovan	Benin*, Chad*, Pakistan, United Kingdom
Eken	Bahamas, Bangladesh, Haiti, Norway, Sweden
Flickenschild	Austria, Paraguay*, Peru, Switzerland*
Ghesquiere	Belgium-Luxembourg, Bolivia, France, Nicaragua, Rwanda* Morocco*, Trinidad and Tobago, United States*
Hino	India*, Malta, Singapore
Huh	Canada, Iceland, Indonesia, Yemen Arab Republic, Zimbabwe Japan*, Saudi Arabia
Kalter	Grenada, Guyana, Jamaica, Liberia, St. Vincent
Keller	Egypt, Germany*, Lebanon*, Seychelles, Turkey*
Kirmani	Ecuador, Ireland, Yugoslavia
Lee	Ghana, Nepal, Oman, Solomon Islands
Lipsky	Philippines*
Lipton	Afghanistan, Dominica, Libya, Maldives
Loser	Mexico
Maciejewski	Ivory Coast*, Viet Nam*
Mansur	Antigua and Barbuda, Bahrain, Fiji, Jordan, Qatar
Martelino	Denmark, El Salvador, Equatorial Guinea, Malawi, Sudan, Costa Rica Bhutan, Sierra Leone, Somalia, Syria*, Vanuatu
Neuhaus	Cape Verde, Guinea-Bissau, Portugal, São Tome e Principe, Senegal*
Nowak	Australia, Kuwait, New Zealand, Uganda
Osunsade	Guinea*
Paljarvi	Hong Kong, Malaysia, Romania
Pera	Colombia, Congo, Laos*, Panama
Perez	Argentina, Chile, Uruguay, Venezuela
Puckahtikom	Korea
Reichmann	Brazil*
Sukachevin	Zambia
Swiderski	Cameroon, Comoros, Djibouti*, Gabon, Honduras
Tseng	Botswana, Lesotho, Mauritius, Papua New Guinea, Swaziland
Tyler	Algeria*, Burundi*, Dominican Republic, Madagascar*, Tunisia*
Zaryndakia	Cyprus, Greece, Kenya, Sri Lanka

1/ Assignments shown in this list (as of November 6, 1981) are superceded by mission participation since then. (Assignment is on the basis of the most recent subsequent mission participation.)

INTERNATIONAL MONETARY FUND

cc: Mr. Quirk

Mr. Williams

Mr. Finch -

I would like to
have your latest
figures on arrears on
foreign debt and their
evolution. (You had
some very interesting figures
in one of your reports on
capital flows 2 years ago).

Jim

July 7, 82

If possible before I leave
for Europe

Managing Director

INTERNATIONAL MONETARY FUND

July 9, 1982

To: The Managing Director

Attached is material relating to your request for information before you left on debt servicing arrears.

Attachment

cc: Mr. Carter

C. David Finch



Office Memorandum

TO : Mr. Finch DATE: July 9, 1982

FROM : Peter J. Quirk

SUBJECT : Debt Arrears: Information Requested by Managing Director

Attached are a note and tables setting out the information on debt arrears requested by the Managing Director. They drew mainly on the recent arrears paper (EBS/82/57). Attached also is a copy of a table "Summary of Multilateral Negotiations, 1975-80" from External Indebtedness of developing Countries (SM/80/273) which is the closest match we could locate to the figures cited by the Managing Director in his note to you.

Attachment

cc: Mr. Williams
Mr. Reichmann
Mr. Huh

7/9/82

External Debt Arrears

Information on payments arrears with respect to debt service payments is set out in the attached Table 1 for the 17 Fund members known to be incurring this form of arrears as of end-1981 for whom amounts are available. An additional 11 members (Chad, Congo, Dominican Republic, Guinea, Guinea-Bissau, Guyana, Haiti, Honduras, Liberia, Madagascar, and Tanzania) were known to be incurring arrears on current and capital payments, although recent information is not available to ascertain if arrears on debt service payments in particular are involved.

Table 2 shows related information on debt arrears that were rescheduled as a result of multilateral debt renegotiations during the period January 1981 to March 1982. In the absence of this rescheduling--which represents a more desirable method of deferring payments but also reflects negatively on the solvency of the country--arrears with respect to debt servicing would have been correspondingly higher.

Separate from debt arrears are arrears with respect to trade. Two members (The Gambia and Zambia) are keeping their debt payments current while delaying other payments. Other members noted above have delayed both forms of payments, and an even more severe test of a country's solvency is provided by the overall level of external payments arrears (Table 3).

For the purpose of inter-country comparisons, the data on arrears in Tables 1 and 3 have been scaled to debt service payments and imports, respectively. The first table shows (in the extreme right hand column) the estimated average length of delays (in months) in the making of debt service payments by countries known to be experiencing delays. The delays are longest for

Togo (12 months), Mali and Uganda (9 months), Costa Rica (8 months), and Ghana and Sudan (7 months). In Table 3 (also in the extreme right hand column) total outstanding arrears are expressed in terms of months of imports. These estimated average delays are longest for Tanzania (9 months), Chad (7 months), Costa Rica and Zambia (6 months), and Ghana and Zaire (5 months).

Attachments

Table 1. Arrears on External Debt Service Payments, 1979-81 ^{1/}(In millions of SDRs; end of period
unless otherwise noted)

	1979	1980	1981	Arrears on debt service payments in 1981 as a ratio of		
				Total payments arrears (In per cent)	Total debt service payments In per cent	In months
Bolivia	...	...	43 <u>2/</u>	54	10	1.2
Costa Rica	--	--	344	60	64	7.7
El Salvador	--	4	4	6	12	1.4
Ghana	52	43	47 <u>2/</u>	13	61	7.3
Jamaica	...	30	14 <u>2/</u>	34	8	1.0
Mali	4	10	15	34	76	9.1
Mauritania	15	15	20	100	44	5.3
Nicaragua	363	188	50	100	35	4.2
Romania	--	--	432	44	28	3.4
Senegal	--	7	12 <u>2/</u>	100	8	1.0
Sierra Leone	15	--	26 <u>2/</u>	26	38	4.6
Somalia	13	19	12	52	37	4.4
Sudan	--	--	98 <u>3/</u>	10	57	6.8
Togo	49	22	59 <u>2/</u>	100	98	11.8
Uganda	26	96	75	61	77	9.2
Viet Nam	--	--	27 <u>2/</u>	100	11	1.3
Zaire	648	--	119	24	11	1.3

Sources: External Payments Arrears of Fund Members, 1980-81 (EBS/82/57, 3/31,82); various Article IV consultation reports; and staff estimates.

^{1/} Countries shown are identified as having payments arrears on debt service payments as of end-1981. Amounts include arrears on amortization and interest payments.^{2/} Most recent estimate available in 1981.^{3/} June 1982.

Table 2. Arrears on External Debt Service Payments Rescheduled
Under Multilateral Debt Renegotiations, 1981-March 1982

(In U.S. dollar million)

Arrears outstanding on January 1, 1981 Rescheduled	
Central African Republic	22.9
Madagascar	66.0
Senegal	--
Sudan	157.0 <u>1/</u>
Uganda	15.7 <u>2/</u>
Zaire	370.0 <u>1/</u>

1/ Total amount due in 1981, including outstanding arrears.

2/ Outstanding on June 30, 1981.

Table 3. External Payments Arrears Outstanding, 1975-1981 1/

(In millions of SDRs; end of period)

	1975	1976	1977	1978	1979	1980	1981 2/	1981 arrears as per-centage of:		
								1980 imports	Level of gross official international reserves	1981 arrears as months of imports
Benin	--	...	--	--	22	21	--	...	...	...
Bolivia	--	--	--	--	42	148 3/	80	12	69	1.4
Central African Rep.*	...	35	39	8	42	63	--	15	48	1.8
Chad	9	9	9	22	39	52	...	58	...	7.0
Congo	13	26	44	67	50	22 5/	...	4	...	0.5
Costa Rica*	--	--	--	--	--	222	544 4/	46	481	5.5
Dominican Republic	--	11	--	--	17	37	72 6/	5	41	0.6
Egypt	82	312 7/	862 8/	--	--	--	--	...	...	...
El Salvador	--	--	--	--	--	41	66 4/	7	106	0.8
Gabon	--	--	430	339	--	--	--	...	...	...
The Gambia	--	--	--	--	--	10	15 6/	13	150	1.6
Ghana	138	192	201	393	324	269	365 6/	44	257	5.3
Grenada*	x	x	x	2	1	--	--	--	--	--
Guinea	136	90	119	151	169	95	...	32	...	3.8
Guinea-Bissau	2	7	7	8	5	7	...	17	...	2.0
Guyana*	--	--	27	17	20	23	39 9/	12	664	1.4
Haiti	--	--	--	--	--	--	26 9/	10	154	1.2
Honduras	--	--	--	--	--	--	10	1	11	0.1
Jamaica*	--	--	22	48	42	89	41 9/	5	31	0.6
Liberia*	--	--	--	--	--	--	6	1	30	0.1
Madagascar*	3	5	7	11	13	145	91	15	450	1.8
Mali	--	--	11	18	27	38	54	16	377	1.9
Mauritania*	--	x	9	23	15	15	20 4/	8	14	1.0
Nicaragua	--	--	--	58	363	188	50 10/	8	58	1.0
Peru	--	...	...	115	--	--	--	...	...	...
Romania*	--	--	--	--	--	--	982 10/	14 11/	208	1.7
Senegal*	...	...	...	...	...	7	12 9/	2	240	0.2
Sierra Leone*	4	9	12	17	54	72	99	16	582	1.9
Somalia*	--	--	--	--	13	35	24	11	63	1.3
Sudan*	68	241	572	597	878	1,081	944 12/	76	3,776	9.1
Tanzania*	--	--	--	50	118	238	226	23	1,507	2.8
Togo*	--	--	16	43	49	22	60	6	55	0.7
Turkey*	--	202	1,710	1,523	1,769	1,266	279 6/	4	22	0.5
Uganda*	37	39	21	70	75	178	114 4/	21	2,135	2.5
Viet Nam	--	--	--	--	--	--	33	4	79	0.5
Zaire*	218	385	671	950	1,118	418	497	41	359	4.9
Zambia*	136	223	394	496	351	461	500	48	1,035	5.8
Total	846	1,786	5,183	5,026	5,616	5,263	5,425			

Sources: Country authorities; and staff estimates.

1/ The Table shows data on countries known to have had external payments arrears in any year during the period 1975-1981, or other dates indicated in the footnotes. Defaults, i.e., payments arrears incurred by governments participating in common central bank arrangements (Bank of Central African States (BEAC), Central Bank of West African States (BCEAO), and Eastern Caribbean Currency Authority (ECCA)) and which resulted from the government's inability to obtain domestic currency with which to purchase needed foreign exchange from the common central bank, as well as those incurred by the government or a government entity whose financial operations form part of the budgetary process, are included in these figures. In the former case, it was not possible to distinguish between domestic and external arrears; total arrears are shown.

2/ Latest estimates available in 1981; total based on end-1980 figures, where 1981 figures not available.

3/ Includes SDR 135 million in payments arrears postponed by agreement with creditor banks through early 1981.

4/ December 1981.

5/ March 1980.

6/ October 1981.

7/ April 1976.

8/ April 1977.

9/ November 1981.

10/ Projection for 1981. The entire amount may not represent payments arrears as it is known to include delayed provision of foreign exchange due to administrative delays considered normal.

11/ As a ratio of convertible currency imports.

12/ June 1981.

Symbols:

* Financial program supported by use of Fund resources in effect in December 1981 (including inoperative arrangements).

x Arrears less than SDR 0.5 million.

maturities were generally in the range of 7 1/2 to 10 years. The normal practice was for the interest rate on the rescheduled maturities to be determined by the ensuing bilateral negotiations.

Table 14. Summary of Multilateral Negotiations, 1975-80 ^{1/}

Country and Year	Consolidation Period	Estimated ^{2/} Amount (US\$ million)	Maximum
			Repayment Terms Including Grace Period (In years)
Chile, 1975	1/1/75 to 12/31/75	178	10
Gabon, 1978	arrears as of 12/31/79	631	10
Peru, 1978	1/1/78 to 12/31/79	211	7 1/2
Sierra Leone, 1977	1/1/76 to 6/30/78	16	9 1/2
Sierra Leone, 1980	7/1/79 to 12/31/81	24	11
Sudan, 1979	10/1/79 to 6/30/81	421	10 1/4
Togo, 1979	4/6/79 to 12/31/80	282	9 1/4
Turkey, 1978	1/1/77 to 6/30/79	1,040	9
Turkey, 1979	7/1/79 to 6/30/80	1,000	8 1/2
Turkey, 1980	7/1/80 to 6/30/83	3,000	10
Zaire, 1976	1/1/75 to 12/31/77	186	9 1/2
Zaire, July 1977	1/1/77 to 7/31/77	203	9 1/2
Zaire, Dec. 1977	7/1/77 to 12/31/77	203	9 1/2
Zaire, 1979	7/1/79 to 12/31/80	1,300	10 1/2

Source: Agreed Minutes of the reschedulings.

^{1/} Excludes (a) India, in whose case the two reschedulings were in the context of provision of economic assistance, and (b) countries that have sought, but not undertaken, a rescheduling as of this writing (i.e., Liberia and Pakistan).

^{2/} Includes maturities due and arrears.

The undertakings which were included in the Agreed Minutes covered the customary commitments. These included goodwill undertakings in about a third of the cases (i.e., the creditors' willingness to reconvene with a view to considering renegotiation of further debt service payments). Generally, the undertakings also included a nondiscrimination clause, under which the debtor undertook not to agree to other reschedulings that would result in more favorable treatment than that accorded to the creditors participating in the multilateral framework. There were also, in specific instances, other commitments relating to the early settlement of arrears and to the contraction of new debts. An important undertaking common to all the agreements related to the debtor country's arrangements



Office Memorandum

No further action necessary. CDF 6/28/82

TO : Mr. Finch

FROM : Peter J. Quirk

SUBJECT : Definition of Arrears: Mr. Finaish's Enquiry

DATE: June 21, 1982

The following is in response to your request for clarification and background to the general question raised by Mr. Finaish as to what constitutes external payments arrears, and (in his words) why the word of the country alone is not acceptable in establishing the existence and extent of arrears.

The criteria for identifying arrears were set out in the 1970 and 1980 policy papers (SM/70/139 and EBS/80/190) and applied in the recent information paper (EBS/82/57). To summarize:

1. A reasonable time delay beyond the due date is permissible for examination of bona fides and other processing of reasonable documentation. Generally speaking, this might involve several days, or even weeks, depending on the member; members with arrears most often have average delays exceeding one month.

2. Government action restricting the availability of foreign exchange to nongovernment entities is necessary in order that arrears within the meaning of Article VIII be involved. Arrears of government or government entities, although having similar economic properties, constitute defaults. In the case of members with a common central bank, the unavailability of exchange and consequent delays sometimes result from a statutory limit on recourse to domestic currency, although the central bank stands open to meet all proper requests for foreign exchange--such instances have been dealt with as defaults. These are just as damaging to the member as arrears.

3. Mr. Finaish's question as to the appropriate source of data on arrears may have been prompted by issues having to do with Somalia and Libya that arose in the last two weeks. In the case of Somalia, the World Bank provided AFR with estimates of arrears that were substantially higher than given to the Fund by the authorities, and that would have jeopardized the forthcoming program. The authorities were asked to reconcile the estimates; they reaffirmed the data given to the Fund. As you are aware, Libya was also singled for its arrears at a recent Berne Union meeting; Mr. Drees last week sought our assistance in preparation for the mission to that country. One possibility is that the Libyan authorities may claim that the delays are due to the poor financial position of importers rather than to the availability of exchange. Mr. Drees was informed that this form of argument for treating delays as defaults has been applied only to members with a common central bank for whom the limits are statutory. / ?

Mr. Finaish could be told that arrears generally involve a number of parties and that their existence therefore generally becomes widely known and reported within the international community. Information covering the types and extent of arrears is generally as gathered by the member. Given the undesirable consequences of arrears, and the need to monitor them in order to ensure the effectiveness of policies aimed at their elimination, members are generally anxious to establish the best possible means of gathering the information.

cc: Messrs. Mookerjee (o/r), Beveridge

EBS/82/57

CONFIDENTIAL

March 31, 1982

To: Members of the Executive Board
From: The Secretary
Subject: External Payments Arrears of Fund Members, 1980-81

The attached paper reviewing developments in the payments arrears situation of members is circulated for the information of the Executive Directors.

Att: (1)

INTERNATIONAL MONETARY FUND

External Payments Arrears of Fund Members, 1980-81

Prepared by the Exchange and Trade Relations Department

(In consultation with other Departments)

Approved by C. David Finch

March 30, 1982

Introduction

Developments in external payments arrears maintained by Fund members, the Fund's experience during 1975-80, and policies in this area, were discussed by the Executive Board at EBM/80/153-154 (10/17/80). ^{1/} Many Directors at that time expressed their concern with the rising trend in external payments arrears and expressed the wish that the staff would monitor developments in this field closely, and that the information on payments arrears would be further developed and updated more frequently for the information of the Board.

The present paper reviews developments in the payments arrears situation of members, focusing particularly on 1980 and the first three quarters of 1981, and steps members have taken to deal with arrears. It also examines the implementation of the Fund's policies in this area, particularly in the context of the use of the Fund's resources. The paper is organized as follows: Section II discusses developments in the level of arrears. Section III examines the broad categories of arrears incurred by Fund members, including government defaults. The adverse consequences of maintaining arrears, and methods for reducing and eliminating them are dealt with in Section IV, while the final section discusses the implementation of Fund policies--both in the context of the use of Fund resources and under Articles VIII and XIV of the Fund's Articles of Agreement. ^{2/}

^{1/} Review of Fund Policies and Procedures on Payments Arrears (EBS/80/190, 8/26/80).

^{2/} Payments arrears constitute an exchange restriction under Article VIII, Section 2(a) and Article XIV, Section 2 when the authorities of a country are responsible for undue delays in approving applications or in meeting bona fide requests for foreign exchange for current international transactions, as defined in Article XXX, Section (d). When a government or a government entity whose financial operations form part of the budgetary process fails to meet an external payments obligation due to a lack of domestic currency, the resulting arrears are considered to be defaults rather than payments arrears constituting an exchange restriction within the meaning of Article VIII. Similarly, payments arrears incurred by governments participating in a common central bank are treated as defaults when they are due to the government's inability to obtain domestic currency with which to purchase needed foreign exchange from the common central bank. Although the above distinction is relevant for the purposes of Articles VIII and XIV, in the context of the Fund's policies on the use of its resources, defaults and other forms of arrears involving current and capital payments are viewed as having the same broad macroeconomic character and consequences, and are therefore treated in the same manner.

II. Recent Developments

1. The overall situation, 1975-81

In the period from 1975 to 1979 total external payments arrears incurred by Fund members rose sharply, but have since leveled off at close to SDR 5.5 billion according to information available through the last quarter of 1981 (Table 1). The number of Fund members incurring arrears, however, continued to increase steadily--more than doubling from 1975 to 1981, from 15 to 31 countries. 1/ Aggregate figures for arrears in these years also embodied large shifts in individual countries' amounts. In 1981 a reduction of Turkey's external arrears by some SDR 1 billion was offset by the emergence of arrears of similar magnitude in Romania. Similarly, in 1980 an SDR 0.6 billion decline in Zaire's arrears was largely offset by the increased arrears of a number of other Fund members.

Viewed from the broad perspective of members' overall ability to meet contractual obligations for current payments and debt repayments, the arrears situation has stabilized in recent years, albeit at a high level. Total deferments of payments obligations, comprising both outstanding debt rescheduled and external payments arrears have, broadly speaking, leveled off in 1980 and 1981 in relation both to imports and to outstanding debt of the group of non-oil developing countries (Chart 1). As a ratio both of imports and of outstanding debt, arrears peaked in 1977 (at 2.9 and 2.4 per cent, respectively) and have since declined gradually through to the latter part of 1981 (to 1.5 and 1.3 per cent, respectively). Total amounts of debt rescheduled annually as a result of multilateral and private negotiations (relative also to import flows and to outstanding debt) peaked later in 1979 and declined sharply in 1981. A major element in the large scale of debt relief operations in 1979 and 1980 was the rescheduling of US\$5.3 billion of Turkish debt. 2/

The appraisal of the inability of members to meet external contractual obligations based on these measures, in particular the ratio of total deferred payments to external debt, 3/ is, however, subject to three qualifications:

a. Because external financing is fungible, just as reductions in arrears may be achieved by greater rescheduling, so also may reductions in both arrears and rescheduling be obtained through increased incurrence of new debt or rollover of existing debt (in some instances at below-market terms). There are, however, some indications from the data of Chart 1 of a less

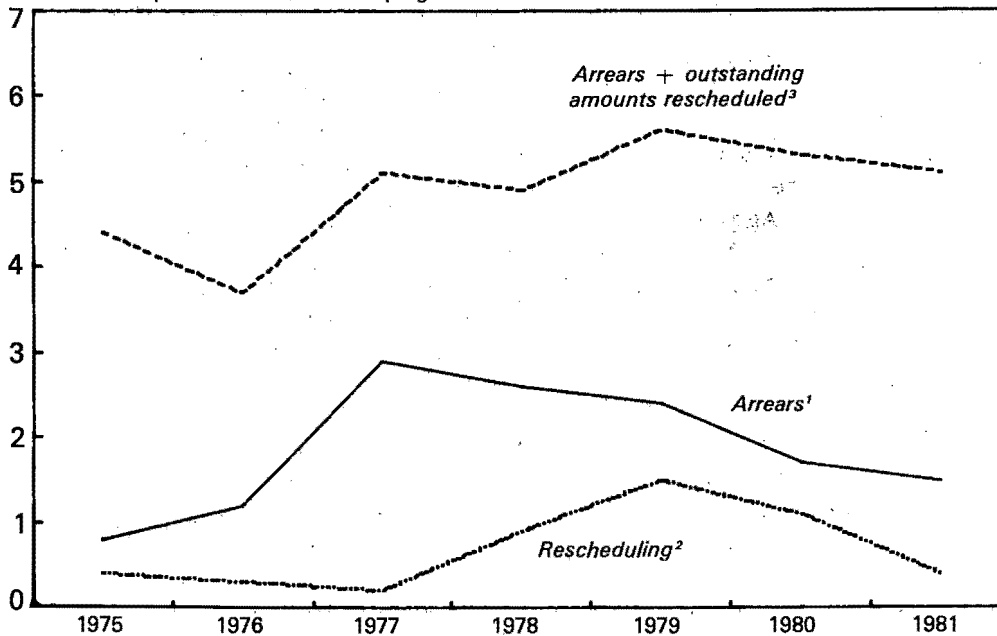
1/ All countries maintaining arrears in the period under examination were in the group of non-oil developing countries.

2/ By comparison, the largest amounts rescheduled in 1981 were US\$0.5 billion each for Bolivia and Zaire.

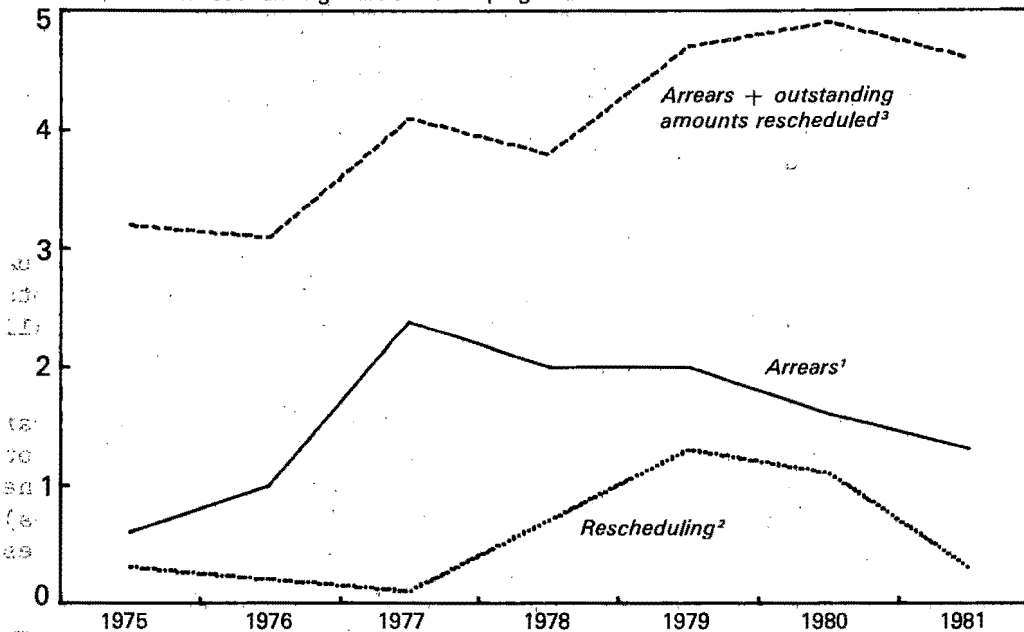
3/ The ratio of overall deferred payments to debt (just over 5 per cent in 1981) when compared with yields (proxied, say, by the LIBOR) may be viewed as an indicator of trends in the risk attaching to these assets.

CHART 1 PAYMENTS DELAYED AND DEFERRED BY FUND MEMBERS, 1975-81

Per cent of imports of non-oil developing countries



Per cent of total outstanding debt of developing countries



Sources: IBRD, *World Debt Tables*; OECD, *External Debt of Developing Countries*; IMF, *IFS*; and staff estimates.

¹From Table 1.

²Amounts rescheduled in each year (flows) are with respect to ODA countries and major private creditors. They include rescheduling with respect to future years.

³Sum of arrears and estimated outstanding rescheduled amounts (stocks as of the end of the indicated year) as a per cent of total imports, and of total outstanding debt, respectively.

Table 1. External Payments Arrears Outstanding, 1975-1981 ^{1/}

(In millions of SDRs; end of period)

	1975	1976	1977	1978	1979	1980	1981 ^{2/}	1981 arrears as percentage of:	
								1980 imports	Level of gross official international reserves
Benin	--	...	--	--	22	21	--	...	...
Bolivia	--	--	--	--	42	148 ^{3/}	80	12	69
Central African Rep.*	...	35	39	8	42	63	29 ^{4/}	15	48
Chad	9	9	9	22	39	52	...	58	...
Congo	13	26	44	67	50	22 ^{5/}	...	4	...
Costa Rica*	--	--	--	--	--	222	544 ^{4/}	46	481
Dominican Republic	--	11	--	--	17	37	72 ^{6/}	5	41
Egypt	82	312 ^{7/}	862 ^{8/}	--	--	--	--	...	...
El Salvador	--	--	--	--	--	41	66 ^{4/}	7	106
Gabon	--	--	430	339	--	--	--	...	...
The Gambia	--	--	--	--	--	10	15 ^{6/}	13	150
Ghana	138	192	201	393	324	269	365 ^{6/}	44	257
Grenada*	x	x	x	2	1	--	--	--	--
Guinea	136	90	119	151	169	95	...	32	...
Guinea-Bissau	2	7	7	8	5	7	...	17	...
Guyana*	--	--	27	17	20	23	38 ^{9/}	11	927
Haiti	--	--	--	--	--	--	26 ^{9/}	10	154
Jamaica*	--	--	22	48	42	89	41 ^{9/}	5	31
Liberia*	--	--	--	--	--	--	6	1	30
Madagascar*	3	5	7	11	13	145	63	11	450
Mali	--	--	11	18	27	38	43	13	331
Mauritania*	--	x	9	23	15	15	20 ^{4/}	8	14
Nicaragua	--	--	--	58	363	188	50 ^{10/}	8	58
Peru	--	...	...	115	--	--	--	...	...
Romania*	--	--	--	--	--	--	982 ^{10/}	14 ^{11/}	208
Senegal*	...	...	...	...	...	7	12 ^{9/}	2	240
Sierra Leone*	4	9	12	17	54	72	99	16	582
Somalia*	--	--	--	--	13	35	24	11	63
Sudan*	68	241	572	597	878	1,081	944 ^{12/}	76	3,776
Tanzania*	--	--	--	50	118	238	226	23	1,507
Togo*	--	--	16	43	49	22	59 ^{6/}	6	55
Turkey*	--	202	1,710	1,523	1,769	1,266	279 ^{6/}	4	22
Uganda*	37	39	21	70	75	178	123 ^{4/}	21	2,135
Viet Nam	--	--	--	--	--	--	27	3	66
Zaire*	218	385	671	950	1,118	418	463	41	359
Zambia*	136	223	394	496	351	461	574	56	1,125
Total	846	1,786	5,183	5,026	5,616	5,263	5,446		

Sources: Country authorities; and staff estimates.

^{1/} The Table shows data on countries known to have had external payments arrears in any year during the period 1975-1981, or other dates indicated in the footnotes. Defaults, i.e., payments arrears incurred by governments participating in common central bank arrangements (Bank of Central African States (BEAC), Central Bank of West African States (BCEAO), and Eastern Caribbean Currency Authority (ECCA)) and which resulted from the government's inability to obtain domestic currency with which to purchase needed foreign exchange from the common central bank, as well as those incurred by the government or a government entity whose financial operations form part of the budgetary process, are included in these figures. In the former case, it was not possible to distinguish between domestic and external arrears; total arrears are shown.

^{2/} Latest estimates available in 1981; total based on end-1980 figures, where 1981 figures not available.

^{3/} Includes SDR 135 million in payments arrears postponed by agreement with creditor banks through early 1981.

^{4/} December 1981.

^{5/} March 1980.

^{6/} October 1981.

^{7/} April 1976.

^{8/} April 1977.

^{9/} November 1981.

^{10/} Projection for 1981. The entire amount may not represent payments arrears as it is known to include delayed provision of foreign exchange due to administrative delays considered normal.

^{11/} As a ratio of convertible currency imports.

^{12/} June 1981.

Symbols:

* Financial program supported by use of Fund resources in effect in December 1981 (including inoperative arrangements).

x Arrears less than SDR 0.5 million.

rapid accumulation of debt in 1980 and 1981 relative to trade. For the non-oil developing country group, the ratio of total public and private debt outstanding and disbursed to total merchandise imports, which had been rising in the period 1976-78, to 129 per cent in 1978, declined to 108 per cent in 1980 and an estimated 110 per cent in 1981.

b. Another qualification attaching to the aggregate indications of the overall situation, as portrayed in Chart 1, is the continuing growth in the number of Fund members incurring arrears or undergoing rescheduling. Although a reduction in the aggregate amounts involved may indicate an overall improvement in the risk climate for creditors, the effects of significant, albeit relatively reduced, amounts of arrears in a wider group of countries signal increased difficulties in debtor-creditor relations. The existence of any significant, and especially protracted, amount of arrears is damaging in this respect (see Section IV for further discussion).

c. The incurrence of new arrears represents, of course, a much less desirable means of deferring contractual payments than rescheduling. In this compositional sense, the situation worsened in 1981--although rescheduling declined sharply, arrears actually increased.

2. 1980-81

At the end of 1979, 26 countries were identified as having payments arrears, including those arising from government defaults, and the total amount of payments arrears was estimated to be SDR 5.6 billion, which was equivalent to 2.4 per cent of total imports of non-oil developing countries. ^{1/} At the end of 1980, with the exception of one country (Grenada), all of the countries which maintained payments arrears at the end of 1979 continued to do so. Moreover, three additional countries were identified as incurring payments arrears (Costa Rica, El Salvador and The Gambia), bringing the total number of countries having payments arrears to 28 (Table 1). The total amount of payments arrears at the end of 1980 was estimated to have amounted to about SDR 5.3 billion, equivalent to 1.7 per cent of total imports of non-oil developing countries. During 1980, five countries with large payments arrears were successful in rescheduling outstanding arrears. These countries were (rescheduled amounts shown in brackets): Congo (SDR 10 million), Guinea (SDR 61 million), Nicaragua (SDR 85 million), Turkey (SDR 500 million), ^{2/} and Zaire (SDR 1 billion).

^{1/} This may be compared with the estimated total for end-1979, in Table 1 of EBS/80/190 (p. 3), of SDR 5.1 billion. For the purpose of estimating totals of outstanding arrears, where the current figure for a particular country is not available, the most recent available figure has been substituted. Figures for individual countries are also subject to revision as more up-to-date or improved information comes to hand.

^{2/} The amounts rescheduled in 1980 and 1981 represent changes in the level of outstanding payments arrears during 1980 and 1981, since very little cash settlements were made during this period. The exact amount of payments arrears rescheduled during each year cannot be estimated since the rescheduling exercise was carried out in several stages and also covered payments that had not yet become due.

In the absence of rescheduling of arrears during the year, the membership total at the end of 1980 for payments arrears would therefore have amounted to nearly SDR 7 billion--an increase of SDR 1.3 billion over 1979.

During 1980 payments arrears increased in 15 countries (in addition to the 3 countries which were identified as acquiring arrears in that year). These were: Bolivia, Central African Republic, Chad, Dominican Republic, Guinea-Bissau, Guyana, Jamaica, Madagascar, Mali, Sierra Leone, Somalia, Sudan, Tanzania, Uganda, and Zambia. In relation to the level of their imports, the increase in payments arrears in 1980 was substantial for a number of these countries. For eight countries the increase in payments arrears in 1980 represented more than 10 per cent of the value of their imports in 1979. These countries were, with increases in payments arrears in 1980 as a per cent of the level of imports in 1979 in parentheses: Bolivia (12 per cent), Central African Republic (38 per cent), Chad (11 per cent), Madagascar (24 per cent), Sudan (129 per cent), Tanzania (14 per cent), Uganda (40 per cent), and Zambia (16 per cent).

Eight countries reduced payments arrears during 1980, and the reductions in payments arrears for Guinea, Nicaragua, Turkey, and Zaire were more than 10 per cent of the level of imports in 1979 (43 per cent for Guinea, 66 per cent for Nicaragua, 11 per cent for Turkey, and 103 per cent for Zaire). Other countries that reduced payments arrears in 1980 were (reductions as a per cent of imports in parentheses): Benin (0.3 per cent), Congo (9 per cent), Ghana (6 per cent), and Togo (7 per cent).

According to the latest information available, payments arrears increased in 1981 and became still more widespread. Outstanding payments arrears were estimated to have amounted to SDR 5.4 billion, slightly more than the level outstanding at the end of 1980 (Table 1). The following countries rescheduled a major part of their payments arrears (rescheduled amounts shown in brackets): Central African Republic (SDR 24 million), Madagascar (SDR 100 million), Nicaragua (SDR 198 million), Sierra Leone (SDR 6 million), Turkey (SDR 987 million), ^{1/} Uganda (SDR 41 million), and Zaire (SDR 80-85 million). In the absence of this rescheduling of arrears, which totaled SDR 1.4 billion, global outstanding payments arrears in the last quarter of 1981 would have amounted to SDR 6.9 billion, representing an increase of almost one third over the outstanding level at the end of 1980.

According to the most recent available data for 1981, 31 countries are known to have maintained payments arrears in that year. Only 1 country (Benin) totally eliminated payments arrears in 1981. Information on the level of arrears outstanding for 4 countries which had payments arrears at the end of 1980 (Chad, Congo, Guinea, and Guinea-Bissau) is not presently available. It is most unlikely that any of these countries were able to eliminate payments arrears by the end of 1981. During 1981, payments arrears emerged in the following 4 additional countries: Haiti (SDR 26 million),

^{1/} Estimated amount; includes settlements of payments arrears under the "Turkish Lira Option". See footnote 2, page 4.

Liberia (SDR 6 million), Romania (SDR 1.0 billion), and Viet Nam (SDR 27 million). Of the countries which maintained payments arrears at the end of 1980, a reduction in the outstanding amount occurred in 10 countries (Bolivia, Central African Republic, Jamaica, Madagascar, Nicaragua, Somalia, Sudan, Tanzania, Turkey, and Uganda). However, in only 5 of these countries did the decline in the outstanding level of payments arrears exceed 10 per cent of the level of imports (58 per cent for the Central African Republic, 12 per cent for Madagascar, 21 per cent for Nicaragua, 45 per cent for the Sudan, 17 per cent for Turkey, and 11 per cent for Uganda). 1/ Declines in arrears in the Central African Republic, Madagascar, Nicaragua, and Turkey were almost entirely due to rescheduling.

The level of outstanding payments arrears increased in 1981 for 13 countries (Table 1). In relation to the level of imports, the highest increase was for Costa Rica (27 per cent) followed by Zambia (16 per cent). Other countries which experienced increases in payments arrears in 1981 included: Dominican Republic (3 per cent), El Salvador (3 per cent), The Gambia (4 per cent), Ghana (10 per cent), Guyana (5 per cent), Mali (2 per cent), Mauritania (2 per cent), Senegal (1 per cent), Sierra Leone (9 per cent), Togo (9 per cent), and Zaire (7 per cent).

III. Types of Arrears

During the past two years there have been improvements in the quality of data obtained by the staff on payments arrears incurred by member countries, particularly with respect to countries which have concluded stand-by or extended arrangements with the Fund. With very few exceptions, the amounts of payments arrears reported here are based on information from official sources, compiled in some instances with the assistance of Fund staff or creditors. 2/ The improvement reflects both the recognition by national authorities of the undesirable consequences of payments arrears and of the need to monitor more effectively the developments in the payments arrears situation, and efforts by the staff to consolidate up-to-date information with the cooperation of the authorities. Continued involvement in multi-lateral debt rescheduling exercises, and the inclusion of policy objectives with respect to payments arrears as performance criteria in stand-by or extended Fund facility programs, have also provided the staff with an opportunity to monitor the data. Nevertheless, further improvements are required in the quality and timeliness of the data on arrears, and related data on the disposition of arrears (especially regarding cash payments); the staff is continuing its efforts in this area. 3/

1/ Decreases in payments arrears in 1981 as a per cent of the level of imports in 1980.

2/ Including information on payments delays provided by the International Union of Credit and Investment Insurers (Berne Union) and the International Air Transport Association (IATA).

3/ At present, little is also known about the bases of measurement in different countries--whether arrears are identified as from the due date of the payment or taking into account normal processing lags or other considerations. Such differences could, of course, influence the quality and comparability of the data.

Available information indicates that, with few exceptions, countries maintained arrears both with respect to debt service obligations (including interest payments) and current payments for imports and invisibles during 1980-81 (Table 2). Five countries (Congo, The Gambia, Guyana, Tanzania, and Zambia) incurred payments arrears with respect to import and current invisible payments (excluding interest payments) only, and six countries (Central African Republic, Mauritania, Nicaragua, Senegal, Togo, and Viet Nam) in 1980 and 1981 incurred payments arrears with respect to external debt service obligations only (including interest payments). In general, on the basis of disaggregated data available for certain countries, payments arrears with respect to import and current invisible payments represented a substantial proportion of total payments arrears (some two thirds in 1979 and 1981, and over three quarters in 1980). Available information also indicates that, in cases where payments arrears were incurred with respect to both current and capital transactions, the proportion of arrears with respect to the two categories of transactions varied considerably in many countries. In some instances, members were able to select forms of payments delays which would be less likely to prove damaging to relationships with their creditors, but, as the diversity of payments categories affected suggests, in the difficult situations of countries incurring arrears, many had relatively little discretion open to them in this respect.

Payments arrears with respect to import payments took a variety of forms. They involved: (1) overdue letters of credit (including instances in which exporters were paid by foreign correspondent banks which had confirmed the letters of credit, but domestic banks were not able to reconstitute their foreign exchange positions with their foreign correspondent banks); (2) delays (usually between one to four months, but in some instances as long as six months) in the provision of foreign exchange for initially approved import transactions; and (3) approval (with little delay) of foreign exchange applications for settlement of payments for imports considered essential (particularly petroleum), but ad hoc approval or indefinite delays in the approval of payments for other imports. Ad hoc or discretionary approval procedures of foreign exchange applications have been most common with respect to transactions for which no specific due dates existed (e.g., unrequited transfers and profit remittances). In some of these instances, it was found to be difficult to identify the nature of delays in the approval of foreign exchange applications since approval was contingent on the production of satisfactory documentary proof (e.g., certificate of tax compliance), thus making it difficult to disassociate the time taken by the official and by the applicant in effecting the transaction. In countries where approvals for foreign exchange applications were granted on the basis of priority lists for imported goods, applicants may have been indirectly treated in a discriminatory manner. However, there is little evidence of direct discriminatory treatment of applicants, except in a few cases in which the provision of foreign exchange was restricted to public sector importers, or foreign exchange applications were approved on the basis of origin of imports. In the case of approval for invisible payments, discriminatory treatment of applicants appears to have existed since approval was often granted on an individual basis. However, there is insufficient information available to assess the extent or the seriousness of this problem.

Table 2. External Payments Arrears, by Type of Payment, 1979-81

(As percentages of total arrears) 1/

	1979				1980				1981			
	Import payments	Invisible payments <u>2/</u>	External debt service payments		Import payments	Invisible payments <u>2/</u>	External debt service payments		Import payments	Invisible payments <u>2/</u>	External debt service payments	
			Interest	Capital			Interest	Capital			Interest	Capital
Bolivia	...	...	...	...	...	...	...	...	...	23	31
Central African Rep.	--	--	26	74	--	--	23	77	--	22	78	
Congo	--	45	55 <u>4/</u>	...	--	100 <u>5/</u>	--	--	...	...	...
Costa Rica	--	--	--	--	100	--	--	--	40	--	40	
El Salvador	--	--	--	--	80	10	4	6	62	32	4	
The Gambia	--	--	--	--	86	14	--	--	81	19	--	
Ghana	47	37	3	13 <u>6/</u>	40	44	3	13 <u>6/</u>	50	37	3	
Guinea	8	--	15	77	7	--	25	68	...	...	...
Guyana	100 <u>3/</u>	...	--	--	100 <u>3/</u>	...	--	--	100 <u>3/</u>	...	--	
Jamaica	...	...	...	...	66 <u>3/</u>	...	34 <u>4/</u>	...	66 <u>3/</u>	...	34 <u>4/</u>
Madagascar	--	100	--	--	68	32	9 <u>4/</u>	...	...	14	...
Mali	44	40	16	--	42	32	25	1	32	34	4	
Mauritania	--	--	33	67	--	--	20	80	--	--	45	
Nicaragua	--	--	12	88	--	--	24	76	--	--	36	
Romania	--	--	--	--	--	--	--	--	50	6	44 <u>4/</u>	
Senegal	--	--	--	--	--	--	100 <u>4/</u>	...	--	--	100 <u>4/</u>	
Sierra Leone	72 <u>3/</u>	...	28 <u>4/</u>	...	...	...	...	...	74 <u>3/</u>	...	26 <u>4/</u>
Somalia	--	--	23	77	47	--	11	42	48	--	3	
Tanzania	100 <u>3/</u>	...	--	--	100 <u>3/</u>	...	--	--	100 <u>3/</u>	...	--	
Togo	--	--	100 <u>4/</u>	...	--	--	100 <u>4/</u>	...	--	--	100 <u>4/</u>	
Turkey	92 <u>3/</u>	...	2	6	97 <u>3/</u>	...	3 <u>4/</u>	...	100 <u>3/</u>	...	--	
Uganda	4	61	35 <u>4/</u>	...	15	31	54 <u>4/</u>	...	9	29	61 <u>4/</u>	
Viet Nam	--	--	--	--	--	--	--	--	--	--	16	
Zaire	39	3	42	16	93	7	--	--	83 <u>3/</u>	...	17 <u>4/</u>	
Zambia	74	26	--	--	57	43	--	--	59	41	--	

Sources: Country authorities; and staff estimates.

1/ The table does not show data on all countries appearing in Table 1, because data on some countries do not exist or are not reliable. For 1981 the latest available data are shown.

2/ Excludes interest payments on external debt.

3/ Includes invisible payments (excluding interest payments on external debt).

4/ Includes principal.

5/ End-March.

6/ Includes deposits awaiting transfers in respect of participation in foreign-owned companies.

Payments arrears of a number of countries in 1980 and 1981 represented government defaults. In all of these cases, payments arrears were incurred either by government or by a government entity whose activities were financed through the government budget. However, in many instances it was not clear whether a lack of domestic budgetary resources or the shortage of foreign exchange was the major reason for the emergence of payments arrears. Most countries for which data on defaults were available in 1980 or 1981 experienced balance of payments difficulties and maintained various forms of exchange restrictions. Thus, it may be assumed that the defaults of the government or public enterprises (which were largely related to external debt service payments) were not entirely attributable to a lack of domestic budgetary resources, and that the shortage of foreign exchange resources might have been at least partly responsible for the emergence of defaults.

A form of default arises when payments arrears are incurred by governments belonging to common central bank arrangements. Several members belonging to such arrangements experienced payments arrears in 1980 or 1981. They emerged in these countries because the governments did not have adequate recourse to domestic currency to purchase foreign exchange from the joint central bank, due to statutory limits on lending by the joint central bank to the participating governments. Payments arrears experienced by these countries represented overdue obligations to both domestic and foreign creditors, but reliable estimates of the breakdown of such arrears are not available.

IV. Consequences of Arrears and Means of Identifying and Reducing Them

1. Consequences

All countries that maintained payments arrears in 1980-81 experienced balance of payments difficulties or deteriorating fiscal positions, and many of them introduced stabilization programs assisted by financial support from the Fund. In general, the existence of payments arrears is likely to have serious effects on the country's ability to conduct satisfactory international transactions, because of the damage it inflicts on the creditworthiness of the country--hindering its access to international capital markets and its ability to borrow on favorable terms. It may also increase the cost of imports to the country as foreign suppliers become reluctant to extend trade credits, or mark up prices of goods or services to insure themselves against the risk of nonsettlement or delayed settlement.

There were indications that a number of countries with outstanding payments arrears during 1980-81 experienced difficulties in obtaining or negotiating favorable loan terms. Available information indicates that the countries which have experienced such problems included Ghana, Guinea, Madagascar, Romania, Sierra Leone, Sudan, Tanzania, Turkey, Uganda, Zaire, and Zambia. Commercial banks in some of these countries encountered difficulties in obtaining confirmation on letters of credit or short-term loans,

particularly suppliers' credits. In some of these countries, the existence of payments arrears and the weakness of economic prospects in general were together responsible for the decline in international confidence.

There is little specific evidence available that foreign suppliers deliberately raised the prices of goods or services exported to the countries incurring payments arrears to cover the additional credit risks which might have been involved, although this practice is probably widespread. In one country (The Gambia) a mark up of about 10 per cent on some goods imported into the country was reported, and some foreign suppliers were known to have insisted on prepayments of letters of credit or their confirmation by more than one foreign bank. As regards difficulties encountered in obtaining insurance or paying unusually high premia by foreign firms or banks supplying goods or services to the countries with outstanding payments arrears, there were several known cases. Most major export insurance agencies at one point had stopped issuing policies covering exports to Tanzania, and export credit agencies in certain countries had also refused to insure exports to Ghana or insured only at considerably higher premia. In addition, official agencies in some countries are known to have occasionally cancelled insurance coverage on exports to Turkey.

2. Identification

In order to direct policies toward achieving a reduction of arrears, they must first be identified. A counterpart deposit requirement in domestic currency against outstanding payments arrears not only facilitates the maintenance of a reliable record on arrears and monitoring of the bona fides of foreign exchange applications, but also helps to effect an orderly elimination of arrears by ensuring that domestic debtors will have sufficient financial resources when the authorities release the foreign exchange. It also helps sterilize liquidity in what is normally an excess demand situation. ^{1/} Only a few countries, however, required such deposits during 1980-81. At the end of 1981 a counterpart deposit requirement was in operation in Costa Rica, Dominican Republic, The Gambia, Guyana, Jamaica, Madagascar, Sierra Leone, and Zambia. In all of these countries the amount of required deposits was equivalent to 100 per cent of the value of foreign exchange applications. With the exception of one country (Costa Rica; discussed below), deposits were either kept at the Central Bank or the commercial banks were forbidden to use such deposits. According to available information, exchange rate guarantees were provided for the deposits in Costa Rica, Madagascar, and Zaire. Provisions for payment of interest on the counterpart deposits are known to exist in five countries (Costa Rica, The Gambia, Guyana, Jamaica, and Zambia), and in Costa Rica, Guyana, and Jamaica the rates were close to

^{1/} It should be noted that this sterilization is in comparison to the situation in which arrears are incurred and no deposit is required.

the prevailing domestic or international market interest rate. 1/ In accordance with the counterpart deposit requirement of Costa Rica (introduced in April 1981), certificates of deposit expressed in U.S. dollars and calculated at the official exchange rate have been issued to depositors. These certificates, bearing LIBOR rates, are redeemable in six half-yearly tranches over three years and are negotiable. A regulation regarding counterpart deposits with respect to foreign exchange applications submitted since June 1981 is under consideration in Uganda at the present time. In one country (Ghana) an advance deposit requirement against foreign exchange applications for certain import payments was in force for some time. The advance import deposits in effect performed the same function as the counterpart deposits when payments arrears emerged with respect to imports subject to the deposit requirement.

3. Means of reducing arrears

In most countries shown in Table 1 the changes in the level of outstanding payments arrears during 1980-81 represented reductions of previously outstanding arrears. In a number of countries, however, new payments arrears emerged in 1980-81 while old arrears were being reduced, so that the changes in the outstanding movement of arrears at the end of the year reflect net reductions of arrears. Information on gross reductions of arrears (including defaults) during 1980-81 is available only for a limited number of countries. As far as the queuing techniques used for obtaining the gross reductions are concerned, it appears that in most cases a first-in first-out principle was applied--although, as noted above, priority lists were in operation for essential imports. It was noted in the 1980 staff paper on arrears 2/ that, although equitable, this principle does not lead to immediate restoration of prompt payments, and may be impractical because of the lumpiness of individual transactions. The staff, however, has no information at hand suggesting that these considerations have taken precedence, although they doubtless have in some instances.

1/ In EBS/80/190 the possible multiple currency practice involved in the payment of inadequate interest or in the absence of an exchange rate guarantee was discussed (p.7):

Where [counterpart] deposits are noninterest bearing, or where the foreign exchange needed to liquidate an external obligation is provided at a future date in exchange for the deposit at the rate of exchange in effect on the due date of deposit rather than at the rate of exchange in effect when the deposit was made, the loss of interest income or any additional cost involved in the purchase of foreign exchange may give rise to a significantly different effective exchange rate and may involve a multiple currency practice. The divergence in the effective rate of exchange, however, will be reduced if interest is paid on such deposits; it will be eliminated if the monetary authorities pay sufficient interest, or if they assume the obligations arising from payments arrears and effectively guarantee the exchange rate to be applied at settlement.

2/ EBS/80/190 (8/27/80), p. 11.

In most of the cases (Central African Republic, Congo, Madagascar, Nicaragua, Sierra Leone, and Zaire), the amounts of net arrears reductions by rescheduling were much larger than those effected by cash payments. 1/ The countries which reduced existing payments arrears entirely through rescheduling during 1980-81 were Bolivia, Guinea, Sudan, and Turkey, while Benin, Costa Rica, The Gambia, Ghana, Mali, Liberia, and Senegal reduced payments arrears entirely through cash payments. In some countries which reduced payments arrears through rescheduling (e.g., Turkey) the data on the exact amount of arrears rescheduled during 1980 or 1981 were not readily available, either because the rescheduled amounts included part of outstanding debt service payments which were due to mature on future dates, or because several rescheduling exercises were conducted throughout the period 1980-81, or the rescheduling exercise continued for more than a year.

Most of the important rescheduling was arranged in the framework of the Paris Club, and the bulk of the Paris Club rescheduling dealt with payments arrears on outstanding debt service payments. An exception was the rescheduling of Turkey's debt, which was conducted under the auspices of the OECD, although principles and procedures of the Paris Club rescheduling were basically adhered to. The countries which benefited with reductions of outstanding arrears through Paris Club exercises in 1980 or 1981 included the Central African Republic, Madagascar, Sierra Leone, Sudan, Togo, Uganda, and Zaire. 2/ The countries which relied exclusively on rescheduling outside the framework of the Paris Club included Bolivia, Guinea, and Nicaragua, and virtually all payments arrears rescheduled in these instances consisted of short- and medium-term debt owed to foreign commercial banks. In the case of one country (Nicaragua) an attempt to reach agreement in the framework of the Paris Club did not succeed, and other negotiations were subsequently concluded.

1/ The major relationships between external arrears, external debt, and external debt servicing may be summarized as follows:

1. Increase (decrease) in outstanding arrears
 - = arrears newly incurred
 - rescheduled arrears
 - cash payments on arrears
2. Increase (decrease) in outstanding debt
 - = debt newly contracted
 - scheduled debt amortization
 - + increase (decrease) in outstanding arrears
3. Actual debt servicing
 - = scheduled debt servicing (interest and amortization)
 - increase (decrease) in outstanding arrears on debt servicing

For the discussion in this paper, stocks (outstanding arrears and debt) are end-year, and flows (arrears newly incurred and debt newly incurred, rescheduled debt and rescheduled arrears, and debt servicing) are within-year.

2/ Executive Directors were advised of the outcome of these negotiations in papers prepared by the staff representatives at the meetings.

In all of the multilateral rescheduling negotiations, the Fund staff played an important direct role, participating in the meetings and offering technical assistance. In addition, in all of these rescheduling negotiations, the conclusion of a stand-by or an extended arrangement with the Fund, or a satisfactory performance under such an arrangement, was considered by the creditors to be a prerequisite for reaching agreement.

V. Implementation of Fund Policies

1. Treatment in programs accompanying use of Fund resources

In December 1981, stand-by or extended arrangements were in effect for the following 18 countries incurring payments arrears: Central African Republic, Costa Rica, Guyana, Jamaica, Liberia, Madagascar, Mauritania, Romania, Senegal, Sierra Leone, Somalia, Sudan, Tanzania, Togo, Turkey, Uganda, Zaire, and Zambia. Of these countries, only the Central African Republic, Jamaica, Liberia, Senegal, Somalia, and Turkey observed the performance criterion relating to payments arrears.

Under the stand-by and extended arrangements, the performance criterion for payments arrears may take two forms: first, if new payments arrears on current payments emerge, the standard performance criterion relating to the policy statement that new exchange restrictions will not be introduced, or existing ones intensified, would not be observed; this performance criterion is included in all stand-by and extended arrangements. Second, in stabilization programs, member countries are normally expected to reach understandings with the Fund to avoid incurring increased payments arrears (including defaults) during the program period, and to take steps to reduce and eventually eliminate arrears. ^{1/} With the exception of one country, Mauritania, for which adequate data was not available, all stand-by and extended arrangements in effect in December 1981 contained a performance criterion requiring a phased reduction or elimination of outstanding arrears during the first year of the program period or throughout the program period. The rationale of this policy has not been that part of additional foreign exchange resources becoming available through drawings from the Fund should be used to reduce the level of payments arrears (and thus reduce exchange restrictions), but, rather, that the improvement in the balance of payments prospects to be expected from the successful implementation of the stabilization program should improve the ability of the countries to meet external obligations--with priority being given to an early elimination of arrears. This is predicated on the view that the assistance provided by Fund resources in reducing arrears should not be assessed in a static way. By normalizing creditor relations, and thus "unlocking" credits, Fund resources in such instances, rather than financing the arrears rundown, may be seen as restoring the member's access to international credits at a sustainable level of real resource inflows.

^{1/} Ibid., p.14.

The following policy guidelines on the elimination of payments arrears in the context of stand-by and extended programs were endorsed by the Executive Board in October 1980: 1/

. . . The technique chosen by a member to reduce outstanding arrears will reflect its institutional arrangements, as well as the magnitude of the arrears and the severity of the balance of payments problem. When payments arrears are large in relation to a member's available foreign exchange resources, it may not be possible to aim at the elimination of the arrears within the program period. Special arrangements may be needed for the renegotiation of outstanding debt obligations when debt problems are particularly severe. Depending on the member's circumstances and the length of the program, it may not be possible, in the early stages of a program, to reach an understanding with the member that goes beyond requiring the avoidance of any further increase in arrears. 2/

As is shown in Table 3, these policy guidelines calling for elimination of arrears over the program period, except when arrears are large in relation to foreign exchange resources, were reflected in programs in effect as of December 1981. In 15 of the 16 countries having identifiable amounts of payments arrears at the time of the conclusion of a stand-by or extended arrangement the ratio of payments arrears to gross official international reserves exceeded 50 per cent, 3/ and in 11 of these countries (Costa Rica, Guyana, Madagascar, Senegal, Sierra Leone, Sudan, Tanzania, Turkey, Uganda, Zaire, and Zambia), outstanding payments arrears exceeded gross official international reserve holdings at the inception of the programs. Elimination of payments arrears by or before the end of the program period was provided for in the stand-by or extended arrangements with Liberia, Senegal, Sierra Leone, Somalia, Sudan, Togo, and Turkey. Under the stand-by arrangements with the Central African Republic, Madagascar, and Uganda, a partial reduction in outstanding arrears was specified for the program period. Under the extended Fund facility programs with Costa Rica, Guyana, Jamaica, and Zambia and the stand-by program with Tanzania, a partial reduction in outstanding payments arrears was stipulated with respect to the first year of the program period, but without a specific target for the entire program period. The extended arrangements with Sierra Leone and Zaire provided for a target for the reduction of payments arrears by the end of the program period and a target for the first year of the program period. In all multi-year arrangements in which a target for the reduction of payments arrears during the program period as a whole was not specified, an understanding was required regarding the reduction of payments arrears in the course of periodic reviews of the program--as a condition governing subsequent phased drawings.

1/ The Fund's policy with respect to payments arrears had been previously reviewed by the Executive Board in 1970 (Executive Board Decision No. 3153-(70/95), 10/26/70).

2/ EBS/80/190, 10/27/80, p. 14 (corrected).

3/ The exception was Togo. Data on payments arrears were not available in Mauritania and payments arrears emerged in Romania after the conclusion of the stand-by arrangement.

Table 3. Treatment of Payments Arrears Under Stand-by or EFF Arrangements in Effect in December 1981 ^{1/}

Country	Type of arrangement effective date, amount, ^{2/} per cent of quota	Total amount of external arrears outstanding at time of program negotiation (SDR million)	Targeted amount of arrears reduction		Ratio of targeted arrears reduction to total arrears		Ratio of targeted arrears reduction to drawing		Rescheduling of arrears planned or in progress at time of program negotiation	Reduction of arrears as a performance criterion		
			During program period	1st yr. of program period	During program period	1st yr. of program period	During program period ^{3/}	1st yr. of program period ^{4/}		During program period	1st yr. of program period	
Central African Rep.	9 mths. SB, 4/10/81 SDR 10.4 m., 43.3%	48	2 ^{5/}	...	4	...	19	19 ^{5/}	yes	yes	...	
Costa Rica	EFF, 6/17/81, SDR 276.75 m., 450%	222	...	83 ^{6/7/}	...	32 ^{6/7/}	...	90	no	yes	yes	
Guyana	EFF, 7/25/80, SDR 100 m., 400%	22	...	11 ^{7/}	...	50 ^{7/}	...	18	no	yes	yes	
Jamaica	EFF, 4/11/81, SDR 477.7 m., 430%	103	...	68 ^{7/}	...	66 ^{7/}	...	38	no	yes	yes	
Liberia	14 mns. SB, 8/26/81, SDR 55 m., 99.1%	8.8 ^{8/}	8.8 ^{7/}	...	100 ^{7/}	...	16	...	no ^{9/}	yes	...	
Madagascar	1 yr. SB, 4/13/81, SDR 109 m., 213.7%	183	43 ^{7/}	...	23 ^{7/}	...	39	...	yes	yes	...	
Mauritania	10 mths. SB, 6/1/81, SDR 25.8 m., 101.2%	...	...	...	...	...	...	...	yes	no	...
Romania	3 yr. SB, 6/15/81, SDR 1,102.5 m., 300%	982 ^{10/}	...	...	...	...	...	...	...	...	...
Senegal	1 yr. SB, 9/11/81, SDR 63 m., 100%	9	9 ^{7/}	...	100 ^{7/}	...	14	...	no	yes	...	
Sierra Leone	EFF, 3/30/81, SDR 186 m., 400%	72	72	29 ^{6/}	100	40 ^{6/}	39	39	yes	yes	yes	
Somalia	1 yr. SB, 7/14/81, SDR 43.13 m., 125%	39	39 ^{6/}	...	100	...	90	...	yes	yes	...	
Sudan	EFF, 5/4/79, SDR 200 m., 227.3%	645	645 ^{11/}	...	100	...	122	...	yes	yes	yes ^{12/}	
Tanzania	1 3/4 yr. SB, 9/15/80, SDR 179.6 m., 326.6%	183	...	30 ^{7/13/}	...	16 ^{7/13/}	...	30	no	yes	yes	
Togo	2 yr. SB, 2/13/81, SDR 47.5 m., 166.7%	10	...	7 ^{14/}	...	7 ^{14/}	100	...	14 ^{14/}	21	...	14 ^{14/}
Turkey	3 yr. SB, 6/18/80, SDR 1,250 m., 625%	1,810	1,810 ^{15/}	...	100	...	145	...	yes	yes	yes ^{12/}	
Uganda	13 mns. SB, 6/5/81, SDR 112.5 m., 150%	310 ^{16/}	11 ^{7/17/}	...	4 ^{7/17/}	...	29 ^{17/}	...	no	yes	...	
Zaire	EFF, 6/22/81, SDR 91.2 m., 400%	418	318 ^{18/}	40 ^{7/19/}	76 ^{18/}	10 ^{19/}	35 ^{17/}	23	yes	yes	yes	
Zambia	EFF, 5/8/81, SDR 800 m., 378%	500	...	139 ^{6/7/}	...	28 ^{18/}	...	66 ^{18/}	yes	yes	yes	

Sources: Based on data from various Executive Board papers on use of Fund resources by the countries concerned.

^{1/} Including inoperative arrangements.

^{2/} Original amount; augmented amount included only in cases where it was stated in the relevant Board paper in anticipation of coming into operation of the Enlarged Access Policy.

^{3/} Ratio of arrears reduction specified during program period to total amount of arrangement.

^{4/} Ratio of arrears reduction during first year of program period to drawings during first year of program period unless otherwise stated.

^{5/} Amount represents arrears reduction through cash payments as a performance criterion; in addition, debt relief resulting from rescheduling was required to be used, in large measure, to effect further reductions in arrears.

^{6/} Calendar 1981.

^{7/} Through cash payments only.

^{8/} At end-August 1981.

^{9/} Letter of intent indicates that, no later than May 31, 1982, external arrears shall be fully paid off or rescheduled.

^{10/} Emerged after the conclusion of the stand-by arrangement.

^{11/} To be eliminated through repayment or renegotiation by the end of the program period.

^{12/} Undertaking not to increase the level of payments arrears.

^{13/} Up to June 1981.

^{14/} The stand-by specifies a phased reduction of total government arrears, but information on external arrears reductions is not available.

^{15/} To be regularized or eliminated during the stand-by period.

^{16/} Arrears estimated at time of program negotiation and since revised to SDR 190 million.

^{17/} During the first four months of the program period.

^{18/} By end of calendar 1983.

^{19/} During the second half of calendar 1981 (i.e., first half of program period).

In discussing the targets for the reduction of payments arrears under stand-by or extended arrangements, the staff took into account such factors as the level of international reserves, the short- and medium-term balance of payments outlook, prospects for rescheduling outstanding arrears, and priorities of debtors and creditors regarding repayment of groups of external obligations that were overdue. ^{1/} Although purchases from the Fund envisaged under the program were not directly linked to the establishment of a schedule of reductions in these instances, they were implicit in the projections of the level of gross official international reserves. In two cases (Guyana and Jamaica) the amount of arrears reduction was directly linked to reserve management. The programs with these countries provided that any accumulation of international reserves by the monetary authorities beyond a certain level (determined on the basis of a projected requirement for foreign exchange) would be used to reduce outstanding payments arrears. As may be observed from Table 3, the application of the above criteria with respect to the target reduction of arrears and the use of resources is reflected in the varying ratios of arrears reduction to drawings available under the programs in effect in December 1981.

In discussing arrears reduction programs with the country authorities, the staff in many instances encouraged the authorities to seek rescheduling of outstanding arrears, especially in cases where arrears consisted of service payments on official debt. Nine of the 18 countries experiencing payments arrears at the time of the conclusion of a stand-by or an extended arrangement in effect as of December 1981 had arranged rescheduling of part of their payment arrears, or were planning to negotiate rescheduling. In establishing the target for the reduction of payments arrears during a program period, the staff took into account the amount of payments arrears rescheduled or expected to be rescheduled and the consistency of the arrears target with more general aspects of the financial program, particularly balance of payments tests and fiscal assumptions. In some instances where rescheduling was expected to be concluded shortly, the performance criterion generally provided that the level of outstanding payments arrears was to be reduced further through additional cash payments which would be equivalent to the amount of rescheduled arrears-- thus ensuring that resources freed up in this way would contribute to a regularization of arrears.

In instances in which the projection of export earnings was found to be subject to a considerable degree of uncertainty, a more frequent review or automatic adjustment of the targets for arrears reduction was provided for in the program. For instance, an extended arrangement with Zambia provided that the targeted amount of arrears reduction for each quarter in 1981 would be reduced by 75 per cent of the shortfall in projected earnings from major exports.

^{1/} The statistical reflection of arrears and their counterpart deposits in the formulation of credit ceilings has also required that attention be given to the need for consistency. The concepts involved are discussed in "Formulation of Credit Ceilings in Stand-by Arrangement" (SM/71/145, 6/11/71), pp.13-14.

2. Policies under the Fund's Article VIII

External payments arrears incurred by member countries represent an exchange restriction subject to approval under Article VIII of the Fund's Articles. 1/ The established policies with respect to the treatment of payments arrears under Article VIII are that, following determination that payments arrears incurred by the member constitute an exchange restriction within the meaning of that Article, approval for maintenance of the restriction is granted only when a satisfactory program for elimination is in place. Furthermore, approval, when granted, is for a temporary period (generally with a fixed terminal date) and, wherever possible, the program for the elimination of arrears is expressed in terms of the level of arrears outstanding.

The present status of exchange restrictions arising from the maintenance of payments arrears by Fund members is summarized in Table 4. The existence of payments arrears was noted in all of the staff reports for the relevant Article IV consultation. In the Executive Board decisions relating to their maintenance as an exchange restriction, approval was granted in 11 instances--all on a temporary basis with a terminal date, and with the exception of 1 case (The Gambia) 2/ approval was granted because the member entered into a stand-by or EFF arrangement which incorporated a reduction in payments arrears as a performance criterion. In the 6 instances of approval involving members with stand-by or extended arrangements in effect in December 1981, the performance criterion for arrears called for a substantial reduction in the first year of the program period (Table 3)--in 5 of the 6 cases, the programmed reductions were approximately a third or more of arrears outstanding at the beginning of the program period. 3/ In 8 cases where the payments arrears were recognized as constituting an exchange restriction involving current payments, approval was not proposed because the member did not express the intention to reduce the level of payments arrears or the programmed reduction was considered inadequate. An early commitment to liberalization of this particularly undesirable form of exchange restriction has therefore been a prerequisite for approval by the Executive Board under Article VIII of the Fund's Articles.

1/ See footnote 2 on page 1 for a discussion of the definition of external payments arrears under Article VIII.

2/ Approval was granted in the light of the intention expressed by the Gambian authorities to reduce arrears, and eliminate them as soon as the foreign exchange position permitted.

3/ The exception is the program with Uganda (see Table 3).

Table 4. Treatment of Payments Arrears In Executive Board Decisions, 1980-1981

	Year of Executive Board consideration of exchange system 1/	Recognition of payments arrears as exchange restriction	Fund Approval 2/
Benin	1981	No 3/	...
Bolivia 4/	1979	No 5/	...
Central African Republic	1981	No 3/	...
Chad	1979	No 3/	...
Congo, People's Republic	1979	No 3/	...
Costa Rica 4/	1980	No 5/	...
Dominican Republic 4/	1981	Yes	No
El Salvador 4/	1978	No 5/	...
Gambia	1981	Yes	Yes 6/
Ghana	1980	Yes	No
Guinea	1981	Yes	No
Guinea-Bissau	1979	Yes	No
Guyana 4/	1981	Yes	Yes 6/
Haiti 4/	1981	Yes	Yes 6/
Jamaica 4/	1981	Yes	Yes 6/
Liberia	1981	Yes	Yes 6/
Madagascar	1981	Yes	Yes 6/
Mali	1981	No 3/	...
Mauritania	1980	Yes	No
Nicaragua 4/	1981	Yes	No
Romania	1980	No 5/	...
Senegal	1980	No 3/	...
Sierra Leone	1980	Yes	Yes 6/
Somalia	1981	Yes	No
Sudan	1981	Yes	No
Tanzania	1980	Yes	Yes 6/
Togo	1981	No 3/	...
Turkey	1982	Yes	No
Uganda	1980	Yes	Yes 6/7/
Viet Nam	1982	Yes 8/	...
Zaire	1982	Yes	Yes 6/
Zambia	1981	Yes	Yes 6/

Sources: Staff reports for Article IV consultation discussions or Executive Board papers dealing with payments arrears of countries concerned.

1/ Refers to the most recent year of Article IV consultation decisions or special Executive Board papers dealing with payments arrears when the country was known to have had payments arrears. In instances in which Executive Board decisions were not adopted in 1980 or 1981, the record of the most recent decision is shown. All recent approvals shown in the table, with the exception of one case, were granted under the Article IV consultation decisions or special Executive Board decisions.

2/ No members maintained external payments arrears under the provisions of Article XIV of the Fund's Articles.

3/ Payments arrears were treated as defaults and were therefore not considered to constitute an exchange restriction subject to Article VIII.

4/ Member has assumed obligations under Article VIII of the Fund's Articles of Agreement.

5/ Payments arrears emerged after the conclusion of the Article IV consultation.

6/ Approval was granted on a temporary basis (with a terminal date).

7/ A temporary approval of payments arrears is proposed in the paper on the review of stand-by arrangement in preparation in March 1982.

8/ Proposed treatment; Executive Board discussion had not yet taken place as of March 30, 1982.



Office Memorandum

Mr Beveridge

VBF

MEMORANDUM TO FILES

March 2, 1982

Subject: Draft Paper on External Payments Arrears--Conversation
with Mr. Habermeier

W 1.

Mr. Habermeier called in response to my memorandum of March 1, 1982 on the question raised by Mr. Hitti concerning the treatment of arrears to the Fund in the above-mentioned draft paper. He said that he was in agreement with the conclusion of that memorandum; namely that the draft paper should not deal with the question of arrears to the Fund. His reasons for this were somewhat different, although overlapping in some respects:

1. Mr. Habermeier said that, so far, arrears to the Fund had been exceptionally limited and he would not wish to convey the notion that they were becoming more generalized by a reference in the paper.
2. Performance criteria for arrears in Fund programs were generally couched in terms of increases and decreases (i.e. as a relative standard and not in absolute terms). A strict avoidance of arrears to the Fund would involve an 'absolute' approach.

Mr. Habermeier said that Treasurer's would circulate a note on the present status of policy and developments with respect to Fund arrears ("overdue financial obligations to the Fund"). As to this latter phrase, used in the staff's papers on the subject, he did not place very much significance on the legal distinction -- to him, arrears to the Fund were arrears.

I asked Mr. Habermeier which countries currently had arrears to the Fund. I mentioned that the Equitorial Guinea case seemed to have been solved recently, but were there other instances? Mr. Habermeier said there were certain informal policy guidelines regarding the notification of these arrears to the Board. Generally speaking, a delay of six weeks beyond the due date would be necessary before such advice was made -- this took place also in consultation with the Managing Director. As of now, there were no countries having overdue obligations to the Fund which had been notified to the Board. I mentioned to Mr. Habermeier that this was perhaps another practical reason for not including arrears to the Fund in the draft paper on arrears as they would not show up at present in the basic Table 1 of that paper.

Mr. Habermeier said that he had also been in touch with Mr. Hitti on the approach suggested above and that Mr. Hitti was in agreement with it.

Quirk
Peter J. Quirk
Division Chief

Exchange Restrictions Division
Exchange and Trade Relations Department

cc: Mr. Mookerjee
Mr. Beveridge ✓



Office Memorandum

cc: Mr. Mookerjee

E. M.

TO : Executive Directors

DATE: December 8, 1981

FROM : C. David Finch *CD*

SUBJECT: Use of Fund Resources and Reduction in External Payments Arrears

At a recent meeting of the Executive Board on Zambia (November 18) there was discussion of the relationship between use of Fund resources and reduction in external payments arrears. We have prepared a note to supplement the answers given at that meeting and, at the request of management, attach a copy for your information.

I might add that we are in the process of collecting further data on external payments arrears and plan to prepare a paper for the Executive Board in the near future.

Attachment

bcc: Mr. Beveridge

cc: The Managing Director
Deputy Managing Director
Mr. Carter

Use of Fund Resources and Reduction in External Payments Arrears

December 8, 1981

The question as to what is the Fund's policy in regard to the use of its resources for the reduction of payments arrears has not been the subject of detailed policy guidelines by the Executive Board. The Board's past discussions on conditionality have always focussed on the linkage between the use of Fund resources and adjustment toward balance of payments viability in an overall sense. However it has always been implicit in these discussions that the concept of balance of payments viability would involve the eventual elimination of external payments arrears, because they are an exchange restriction in the sense of the Fund's Article VIII and also because of the particularly damaging impact of this type of restriction on the credit standing of the debtor country. The Board has also indirectly expressed a policy position in this area, when, in the context of its review of "Fund's Policies and Procedures on Payments Arrears" (EBS/80/190) it concluded that "in the context of stabilization programs supported by use of Fund's resources, member countries are expected to take steps to reduce and eventually eliminate payments arrears relating to capital transactions as well as to payments and transfers for current international transactions." It also observed that "experience has shown that a more flexible approach may be preferable whereby members will not be expected to eliminate arrears over the life of a one-year program, although normally it should remain an objective of programs covering two or three years." (EBS/80/190, p.13)

It should be noted that, of late, there has been a tendency for some Executive Directors, in discussion of particular country programs, to "link" Fund support to particular components of foreign payments, e.g., development-related outlays in the case of the Indian program and debt repayments and arrears reductions in the cases of Uganda and Zambia, respectively.

Such attempts at quantitative "linkage" raise two difficulties. First, since money is fungible, it would be equally valid to argue that some other source of foreign exchange, e.g., exports or other capital inflow, is being used for the payment in question and that Fund support is being used to finance (other) vitally needed imports. Second, and more substantively, it is important to maintain the focus on programs' objective of overall balance of payments viability and the adequacy of supporting measures. An adequate program should clearly show how the current account and overall balance of payments position are expected to evolve toward viability so that the Fund's resources could be repaid in due time. Therefore, the real question is not whether Fund support is being used for particular foreign exchange payments (like arrears reduction),

but whether (i) the desired overall balance of payments viability is attainable and (ii) whether the member is using the totality of available foreign exchange in a manner which would contribute toward that viability.

In regard to external payments arrears alone, an important question is at what pace the reduction in arrears should be effected. Given the severe shortage of foreign exchange faced by many countries seeking Fund support, the Board has recognized that "when payments arrears are large in relation to a member's available foreign exchange resources, it may not be possible to aim at the elimination of the arrears within the program period" (EBS/80/190). The attached table is of interest in this context. It shows that the arrears targets have varied greatly, both as a ratio of their outstanding level as well as of Fund assistance.

In discussing the arrears targets under programs, the staff have given particular attention to the competing demands for exchange, especially for imports to revitalize the economy as well as to the possibility that the progressive liquidation of arrears would lead to the reactivation of capital inflow, especially through the unclogging of import credit facilities. Care has been taken to ensure that, where it can be helpful, the member is assisted to obtain maximum amounts of debt relief. Particular attention has also been given to the possibility of consolidating arrears to commercial banks on term loans, where these have arisen.

With regard to a recent case discussed in the Executive Board (Zambia) two points may be made. One, in that case, arrears were nearly all related to imports; 1/ this increases the possibility that arrears reduction would contribute to the renewed flow of import credits. Second, although the ratio of arrears reduction to use of Fund resources in the last quarter of 1981 is projected to be 0.73, as stated at the Board meeting, in the first year of the EFF as a whole the target reduction in arrears (as modified) amounts to only 12 per cent of the outstanding level at the beginning of the year and 21 per cent of Fund assistance during the year; both ratios are less than the average ratios in the table.

1/ Including, as was clarified during the Board discussion, imports financed by medium-term credit, of which some were under official export-credit guarantees of the exporting countries.

Table. First-Year Arrears Reduction in Recent Fund Arrangements ^{1/}

Country	Use of Fund Resources as a Per Cent of Quota ^{2/}	Reduction of Arrears to: ^{2/}	
		Use of Fund Resources ^{2/}	Outstanding Arrears
Central African Republic	43	.19	.04
Bolivia	98	.63	1.00
Senegal ^{3/}	100	.67	1.00
Liberia	100	.18	1.00
Togo ^{3/}	100	.74	.51
Tanzania	121	.30	.16
Somalia ^{4/}	125	(.16)	.19
Zambia ^{5/}	142	.21	.12
Madagascar	148	.53	.23
Zaire	149	.12	.10
Uganda	150	.20	.07
Costa Rica	150	.87	.33
Jamaica	161	.35	.50
Sierra Leone	160	.37	.39
Guyana	167	.18	.50
Average of total	128	(.34)	(.41)
Average of countries with per cent of quota 100 or less	38	.48	.71
Average of countries in French-Franc Bloc	98	.55	.45

Sources: Country authorities; and staff estimates.

^{1/} The table covers stand-by and extended programs arranged during 1980 and 1981 in which quantified reductions in arrears were specified; data are based on programmed not actual information.

^{2/} During the first year of the arrangement.

^{3/} Includes domestic and foreign arrears.

^{4/} Excludes expected rescheduling of arrears.

^{5/} Takes into account modification as approved by the Board on November 19, 1981.

M. H. ...

INTERNATIONAL MONETARY FUND

October 30, 1981

- Mr. Finch ✓
- Mr. Palmer
- Mr. Mookerjee
- Mr. Beveridge
- Mr. Guitian
- Mr. Kanesa-Thasan
- Mr. Gerhard
- Mr. Quirk

M

Arrears Reduction in Fund Programs

In the course of work on Ghana, I asked Dan Lee to prepare the attached note which might be of interest to you.

Attachment

Eduard H. Brau

E. H. Brau

Mr. Stein

Mr. Finch

October 30, 1981

MEMORANDUM FOR FILES

Subject: Arrears Reduction in Recent Fund Programs

The purpose of this note is to provide answers to the following questions that arose in the course of negotiating a stand-by arrangement with Ghana: (1) Has there been any systematic relationship between the amount of Fund support and the required reduction in arrears in recent Fund-supported programs? (2) Has there been a general tendency of back-loading in arrears reduction schedules?

To answer these questions, the first-year arrears reduction schedules in 16 recent programs (two for Madagascar) supported by Fund arrangements (EFF or upper credit tranche stand-by) in those countries with arrears were studied. 1/ Five countries among those reported received simultaneous approvals for CFF purchases. The result is summarized in the attached table. Some programs among those reported were not helpful in answering the questions because there were (a) a program (Jamaica) that did not have any specific arrears reduction scheme but only indirectly through limits on reserve holdings; (b) programs (Bolivia, Central African Republic, and Guyana) that had no phasing, although they had reduction targets for the first year as a whole; and (c) programs (Sudan and Turkey) that only required arrears to be limited at the current level.

As regards the first question, the last two columns in the attached table show the ratios of arrears reduction to the Fund resources provided during the first year of the program. The very high ratios in the programs for Costa Rica and Madagascar (June 30, 1980) become much less when resources under the CFF are included in the calculation, although they still belong to the higher side. However, the ratios in the programs for Tanzania and Uganda belong to the lower side, despite the existence of simultaneous CFF purchases. This might be an indication that arrears reduction heavily reflects CFF resources. In any case, the ratios to total Fund support are widely distributed between zero and almost 90 per cent, and it is difficult to detect any systematic relationship. 2/

1/ There were 26 countries which had payment arrears as of June 1981, of which 15 countries had programs supported by the Fund through either EFF or upper credit tranche stand-by arrangements.

2/ It should be noted that some programs (Guyana, Madagascar, Somalia, Sudan, Turkey, and Zaire) envisaged reductions in arrears through rescheduling, as well as through cash payments. This makes it even more difficult to compare the proportion of the Fund resources to be used for reduction in arrears.

It is possible to hypothesize that high (low) ratios of arrears reduction to the Fund support could be due to the high (low) level of outstanding arrears. However, we are not able to find any such systematic relationship in the attached table. For example, the relatively high ratio of arrears reduction to Fund support for Costa Rica might be attributed to the high level of outstanding arrears; but this is not borne out by other countries with large arrears, such as Tanzania, Uganda, and Zaire. It should also be noted that some countries with relatively small arrears, such as Bolivia and Somalia, were scheduled to eliminate outstanding arrears completely, resulting in high ratios of arrears reduction to the Fund support, which is, however, not borne out by Guyana.

As regards the second question, the answer is again completely mixed--some programs show definite back loading (Central African Republic, Madagascar, and Somalia), and some definite front loading (Sierra Leone and Zaire) with the rest of them difficult to tell. The memorandum items in the attached table show the weighted average of the phasings of arrears reduction as ratios to the total reduction in the first year. Because some programs have targets for arrears reduction for only three periods (Madagascar (June 30, 1980), Zaire and Zambia), the weighted average is calculated for two different groups--four-period phasings and three-period phasings. For both groups, on average, there is no strong evidence of either front- or backloading; rather, the phasings would look, on average, even-loaded. However, the result with the weighted averages should be discounted considerably, in view of the wide variance in individual phasing schemes.

The proposed one-year stand-by program to be negotiated with the Ghanaian Government includes arrears reduction of US\$100 million, phased in four equal quarterly reductions of US\$25 million. Total Fund resources to be provided would amount to about SDR 320 million, including the CFF purchase of SDR 120 million. The proposed arrears reduction will be about a quarter of the total Fund support, and about 29 per cent of total arrears outstanding.

Dan Lee
Dan Lee

International Capital
Markets Division

Attachment

cc: Mr. Brau ✓

First-Year Arrears Reduction in Recent Programs Supported by the Fund 1/

Country (Quota in millions of SDRs)	Date	Use of Fund Resources <u>2/</u>		Total <u>2/</u> Arrears Reduction (In millions of SDRs) (3)	Arrears Outstanding (In millions of SDRs) (4)	Ratio of Quarterly Phasing to Total Arrears Reduction				Ratio of Arrears Reduction to Outstanding (4)/(3) (In per cent)	Ratio of Total Arrears Reduction to the Fund Support	
		(In millions of SDRs) (1)	CPF (2)			I	II	III	IV		(3) (1)	(3) (1) + (2)
Bolivia (67.5)	Feb. 1, 1980	66.375	--	42.0 <u>3/</u>	42.0	... <u>3/</u>	42.0 <u>3/</u>	--	--	100.0	63.3	--
Central African Republic (24.0)	Apr. 10, 1981	10.4	--	2.0	54.0	12.5	12.5	37.5	37.5	3.7	19.2	...
Costa Rica (61.5)	June 17, 1981	92.25 <u>4/</u>	30.1	80.0 <u>4/ 5/</u>	240.0	...	...	...	...	33.3	86.7	65.4
Guyana (37.5)	July 1980	62.625	--	11.1 <u>5/</u>	22.2	...	...	...	...	50.0	20.4	...
Jamaica (111.0)	April 13, 1981	178.2	37.0	... <u>6/</u>	97.6	...	...	...	...	...	...	...
Madagascar (51.0)	April 13, 1981	75.35	--	39.1 <u>7/</u>	172.0	9.7	26.1	30.2	34.0	22.7	53.3	...
	June 30, 1980	38.15	29.2	46.2	51.4	24.0	31.2	44.8	...	89.9	121.1	68.6
Sierra Leone (46.5)	March 30, 1981	74.4 <u>8/</u>	--	27.8	72.0	47.3	57.9	-5.4	--	38.6	37.3	...
Somalia (34.5)	June 15, 1981	43.13	--	37.2 <u>9/</u>	37.2	8.1	8.9	41.4 <u>10/</u>	41.4	100.0	86.6	...
Sudan (132.0)	May 4, 1979	50.0	--	-- <u>11/</u>	654.0	--	--	--	--	--	--	...
Tanzania (82.5)	Sept. 15, 1980	100.0	15.0	30.0	183.0	--	33.3	33.3	33.3	16.4	30.0	26.1
Togo (28.5)	Feb. 17, 1981	28.5	--	21.0	41.0	16.7	33.3	33.3	16.7	51.2	73.7	...
Turkey (300.00)	June 18, 1980	460.0	--	-- <u>12/</u>	1,960.0	--	--	--	--	--	--	...
Uganda (75.0)	June 8, 1981	112.5	45.0	11.0	310.0	100.0	--	--	--	3.5	9.8	7.0
Zaire (228.0)	June 22, 1981	340.0	--	40.0	418.0	50.0	25.0	25.0	... <u>13/</u>	9.5	11.8	...
Zambia (211.5)	May 8, 1981	300.0	--	139.0	500.0	32.4	32.4	35.3	... <u>13/</u>	27.8	46.3	...
Memorandum Item:												
Weighted average for 4-period phasings <u>14/</u>		444.28	60.0	168.0		20.1	28.1	25.9	25.6	21.1	37.8	33.3
Weighted average for 3-period phasings <u>15/</u>		678.15	29.2	225.2		33.8	30.8	35.4	...	23.2	33.2	31.8

Source: Various Fund program papers and staff estimates.

1/ The table covers the most recent programs (EFF or upper credit tranche stand-by) in those countries with payments arrears.

2/ During the first year of the program. In the cases where the amounts are augmented later, the original programs are reported.

3/ The Government intended to eliminate arrears completely during the first half of 1980.

4/ By end-1981.

5/ No phasing.

6/ The program has only reserve limits until all arrears are eliminated. Two thirds of the outstanding arrears was expected to be eliminated during the first year.

7/ Includes arrears on transfers of dividends. Rescheduling also required.

8/ No purchase in the fourth quarter.

9/ The reduction in arrears is to be achieved either by cash payments or rescheduling.

10/ No arrears reduction target for the third quarter. The amount is one half of the reduction scheduled for the third and fourth quarters.

11/ Limited to US\$850 million throughout the program period.

12/ Further accumulation is not allowed.

13/ No target for the fourth quarter.

14/ Central African Republic, Madagascar (April 13, 1981), Sierra Leone, Somalia, Tanzania, Togo, and Uganda.

15/ Madagascar (June 30, 1980), Zaire, and Zambia.



Office Memorandum

mt

TO : Mr. Robichek

DATE: April 30, 1981

FROM : C. David Finch *DF*

SUBJECT : Information on Payments Arrears

Not unexpectedly, you have raised questions about the classification of Grenada as having payments arrears. We were, of course, aware of the special features in the case of Grenada, which you raised when it was one of the countries identified in the Annual Report on Exchange Arrangements and Exchange Restrictions, 1980 (AREAER) as having external arrears as a result of governmental default. Fortunately, the immediate problem is eased as we have been told by the Commonwealth Caribbean Division that these arrears have now been eliminated and we propose to record this fact in the coming AREAER. We were, however, surprised at the query on Bolivia. Our information on the arrears of Bolivia was taken from the staff paper Bolivia--Request for Stand-By Arrangement (EBS/80/17, 1/22/80) and the 48-hour report of Mr. Caiola of March 3, 1981.

On the general point, we acknowledge that the definition used of arrears may not be generally welcomed. However, given that the definition endorsed by the Executive Board in its review of Fund policy in October 1980 dealt specifically with arrears in countries with joint central banks in Africa as governmental defaults on external obligations arising from a shortage of domestic currency, we necessarily have to do the same in all such cases. Such arrears, it should be recalled, do not involve restrictions in terms of Article VIII. Our request for verification of data on arrears does not involve your endorsement of the concept, but merely confirmation that our information on such arrears or defaults is as accurate as possible.



Office Memorandum *cc: J. J. Sheehan*

TO : Mr. Finch
FROM : E. Walter Robichek *ER*
SUBJECT : Information on External Payments Arrears

DATE: April 29, 1981

I have asked the divisions handling Costa Rica, the Dominican Republic, Guyana, Jamaica, and Nicaragua to check and update the figures on external payments arrearage in the table attached to your note of April 28 on the above subject. I am not optimistic about our ability to provide the update for Nicaragua's arrearage as of the end of 1980. With regard to Grenada, I will state once again for the record that Grenada has never had external payments arrears in the sense in which I understand this term. The figures for arrearage for that country appearing in your table refer to external obligations which the government has failed to meet--for example, its annual contributions to the University of the West Indies. The same applies to the arrearage figures shown for Bolivia, a country which does not apply any exchange restrictions whatever. As you know, I consider these cases defaults by governments and public enterprises which lack the local currency to service their external obligations; in Grenada there is no central bank that could advance the local currency, and in Bolivia the Central Bank is resisting providing the deficit financing. Therefore, if you persist in showing these two countries with external payments arrearage you cannot claim to have checked your figures with the area department concerned.

cc: Mr. Caiola
Mr. Albertelli/Mr. van Houten
Mr. Quirk





Office Memorandum

TO : Heads of Departments: AFR, ASD, EUR, MED, WHD DATE: April 28, 1981

FROM : C. David Finch *CF*

SUBJECT : Information on External Payments Arrears

In the Executive Board's discussion last October on "Review of the Fund's Policies and Procedures on Payments Arrears" (EBS/80/190, 8/27/80), a number of Executive Directors asked to be kept informed of important developments in the evolution of arrears incurred by members. A further review of the problem of arrears was given in "External Indebtedness of Developing Countries" (SM/80/273, 12/24/80), which was considered by the Board in January. In addition, developments in payments arrears in 1980 and early 1981 are described in the Annual Report on Exchange Arrangements and Exchange Restrictions (AREAER) 1981--Part One which was circulated to departments last week.

To provide the basis for this review, we need your continuing help. Attached is the table which has formed the basis for these reviews, derived mainly from staff reports on consultations and on members' requests for use of Fund resources. It would be appreciated if any revisions to the data or new information on outstanding arrears in countries in your Department could be given to Mr. Quirk, Room 5-120, by the close of business on Tuesday, May 5, to ensure that the AREAER, although it does not include data on individual countries, is reasonably accurate in its broad description. We would also appreciate your cooperation in updating material, in particular in commenting on updates of the table which will be circulated at regular intervals.

Attachment

April 27, 1981

External Payments Arrears Outstanding, 1975-80

(In millions of SDRs; where applicable, end of period)

	1975	1976	1977	1978	1979	1980
Bolivia*	--	--	--	--	42	135
Central African Republic*	...	35	39	45	46	48
Chad	9	12	18	22	...	...
Congo*	...	11	23	42	23	...
Costa Rica*						176
Dominican Republic	--	11	--	--	33	63
The Gambia	--	--	--	--	--	10
Ghana*	201	259	261	375	303	260
Grenada*	xx	xx	xx	2	1	...
Guinea	50	79	109	138	152	...
Guinea-Bissau	1	6	7	8 <u>1/</u>	...	...
Guyana*	--	--	27	8	5	22
Jamaica*	--	--	22	48	42	89
Madagascar*	...	...	...	1 <u>2/</u>	12	172
Mauritania*	--	xx	9	23	15	...
Nicaragua	--	--	--	31	88 <u>3/</u>	...
Sierra Leone*	4	9	12	17	54	72
Sudan*	68	241	498	610	906	1,128
Tanzania*	--	--	--	50	118	173
Togo*	--	--	16	43	79	42
Turkey*	--	201	1,409	1,523	1,897	1,472 <u>4/</u>
Uganda*	37	39	21	79	134	268
Zaire*	218	385	671	950	1,118	418
Zambia*	136	223	394	495	350	461
Total <u>5/</u>	724	1,511	3,536	4,510	5,448	5,288

Sources: Country authorities; and staff estimates.

* Financial program supported by the use of the Fund's resources in effect during 1980 or early 1981.

1/ November 1978.

2/ May 1978.

3/ March 1979.

4/ October 1980.

5/ Where outstanding year-end figures are not available, the latest available figures are used.

Note: xx: Arrears less than SDR 0.5 million.

...: Information not available.

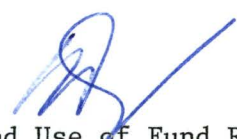
--: Payments arrears nonexistent.



Office Memorandum

11

TO : Mr. Finch

FROM : John B. McLenaghan 

SUBJECT : Payments Arrears and Use of Fund Resources Programs

DATE: January 23, 1981

Preparation of the attached table was prompted by questions raised in connection with the mission to Costa Rica. Based on the list of countries with external payments arrears reported in last year's paper reviewing Fund policy on arrears (EBS/80/190), the table shows: (1) countries applying a requirement of counterpart deposits for external payments arrears; and (2) commitments by members with respect to the elimination, reduction, or avoidance of an increase in arrears during the first year of the program period and over the life of the program. The most noteworthy feature is the small number of programs that provide for the elimination of arrears.

Attachment

cc: Mr. Palmer
Mr. Mookerjee
Mr. Kanesa-Thasan
Mr. Guitian
Mr. Gerhard
Mr. Nowzad

Table . External Arrears Commitments in Use of Fund Resources Programs, 1979-80

Country	Type of Fund Facility <u>1/</u>	Length of Program and Expiry Date	Counter-part Deposits	External Arrears Commitment During Program period			External Arrears Commitment During First Year of Program		
				No increase	Reduction	Elimination	No increase	Reduction	Elimination
Bolivia	SBA	12 months (2/1/81)	No			X			X
C.A.R.	SBA	12 months (2/15/81)	No	X			X		
Congo	SBA	12 months (4/25/80)	No		X			X	
Ghana	SBA	12 months (1/10/80)	Yes <u>2/</u>		X			X	
Grenada	SBA	13 months (12/31/80)	No		X			X	
Guyana	EFF	36 months (7/1/83)	Yes		X			X	
Jamaica	EFF	36 months (6/9/81)	Yes			X	X (certain arrears)		X (certain arrears)
Mauritania	SBA	20 months (3/30/82)	No			X	(no commitment) <u>4/</u>		
Nicaragua	SBA	18 months (12/31/80)	Yes			X			X (by 9/30/79)
Sierra Leone	SBA	12 months (11/2/80)	Yes		X			X	
Sudan	EFF	36 months (5/4/82)	Yes <u>3/</u>	X (first year)		X (by re-scheduling)	X		
Tanzania	SBA	21.5 months (6/30/82)	Yes		X			X	
Togo	SBA	18 months (12/31/80)	Yes		X		X (by mid-1982, beyond program period)	X	
Turkey	SBA	36 months (6/18/83)	Yes	X (first year)		X (rest of period)	X		
Uganda	SBA	12 months (12/31/80)	Yes		X			X	
Zaire	SBA	18 months (2/27/81)	Yes		X			X	
Zambia	SBA	24 months (4/26/80)	Yes		X			X	

1/ In effect in 1979 or 1980. The programs for the C.A.R. and Grenada involved the first credit tranche; the others involved upper credit tranches.

2/ Except for arrears arising out of backlog of profits and dividends.

3/ Only for arrears arising out of public obligations.

4/ Authorities will compile inventory by end of 1980.

DRAFT
JBMcLenaghan:jg
October 16, 1980

Policies and Procedures on Payments Arrears--
Statement by Staff

This paper is intended to give the Executive Board an opportunity to review the Fund's policies on payments arrears, which were last reviewed in 1970, and to be responsive to questions raised recently by several Directors during Board discussions concerning Fund policies and procedures on arrears. In this respect, we have tried to clarify some of the procedures we have been following in dealing with the problem of arrears in individual cases.

As a means of helping to focus the discussion perhaps I could mention two areas on which Executive Directors might like to comment:

One of the problems that has emerged in recent years concerns arrears of external payments that are not considered to involve exchange restrictions within the meaning of Article VIII. The Board has dealt with a number of these cases, most recently in the Article IV consultation with Togo. What we are proposing in the paper is that the Board recognize, as a matter of policy, the approach and procedures that the staff has been applying in these cases. The fact that such arrears fall outside the Fund's approval jurisdiction does not lessen the Fund's concern that the members with such arrears should make every effort to return to a system of prompt payments. This, of course, is already reflected in the treatment of these arrears in staff appraisals in consultation reports and in programs supported by use of the Fund's resources.

The second main area of concern relates to arrears and their treatment in adjustment programs. The illustrative data appearing in the table on page 3 of the paper give an indication of the importance of the arrears problem in present circumstances and the extent to which most of the

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countries with payments arrears are being supported by the financial assistance of the Fund. In line with the procedures we have been following in most of these cases, the paper proposes more flexible procedures than those embodied in the Board's decision on arrears taken in 1970. This seems to be fully in accord with our policies on conditionality.

FOR
AGENDA

EBS/80/190

a Cor. 1,

CONFIDENTIAL

August 27, 1980

To: Members of the Executive Board

From: The Acting Secretary

Subject: Review of Fund Policies and Procedures on Payments Arrears

The attached paper reviewing Fund policies and procedures on payments arrears will be brought to the agenda for discussion on a date to be announced.

Att: (1)

INTERNATIONAL MONETARY FUND

Review of Fund Policies and Procedures on Payments Arrears

Prepared by the Exchange and Trade Relations Department

(In collaboration with Legal and Other Departments)

Approved by C. David Finch

August 26, 1980

I. Introduction

A staff memorandum in 1970 ^{1/} reviewed the Fund's experience with respect to arrears on payments and transfers for current international transactions and analyzed a number of factors relating to the emergence of arrears and the effects of arrears in the member countries in which they occur. It considered various approaches used by members in seeking to eliminate arrears and summarized the Fund's treatment of arrears, including the treatment of arrears in the context of programs supported by use of the Fund's resources. In completing its review of SM/70/139 the Executive Board endorsed a number of conclusions. ^{2/} Among these conclusions, the Executive Board noted that undue delays in the availability or use of exchange for current international transactions that result from a governmental limitation are payments restrictions under Article VIII, Section 2(a) and Article XIV, Section 2. Particular emphasis was placed on the adverse effects that arrears may have on the creditworthiness of a debtor country and on the smooth functioning of the international trade and payments system. The staff was therefore called upon to aim in consultation reports at a more systematic treatment of exchange restrictions involving payments arrears. In addition, the Executive Board set forth the circumstances in which the Fund would grant approval of such arrears. Finally, a number of requirements were prescribed, in terms of performance criteria and policy understandings, for members having payments arrears and seeking financial assistance from the Fund.

The period of about 10 years that has elapsed since the issuance of SM/70/139 has witnessed a substantial increase in the incidence of payments arrears. This has been especially marked in the last few years. The widespread occurrence of payments arrears and the sharp increase in the total amount of arrears outstanding since the mid-1970s reflect the prolonged and severe external payments imbalances and related adjustment problem experienced in a growing number of countries. Executive Directors have expressed their concern at these developments, most recently in the 1980 Annual Report on Exchange Arrangements and Exchange Restrictions (SM/80/98, 5/2/80 and Rev. 1), and on several recent occasions have asked for a further review by the staff of the experience with payments arrears and the factors giving rise to them.

^{1/} "Payments Arrears in Current International Transactions", (SM/70/139, 7/6/70).

^{2/} Executive Board Decision No. 3153-(70/95), adopted October 26, 1970.

The present paper reviews the Fund's policies on payments arrears in light of the experience over the period since 1970 and examines some of the policy problems that have emerged in this area. Particular attention is given to the circumstances of countries in which payments arrears have emerged in recent years, including those members for which the Fund has provided financial assistance in support of programs of adjustment. The paper also focuses on operational problems in dealing with payments arrears, as well as on aspects of payments arrears that involve the Fund's approval jurisdiction under Article VIII. In some of these areas the staff is seeking guidance from Executive Directors in a re-evaluation of existing guidelines and in the formulation of new ones.

The paper is organized as follows. Section II examines the policy setting and implications of payments arrears, while Section III is concerned with the definition, identification and measurement of arrears. Section IV deals with the question of payments arrears as exchange restrictions and their treatment in consultation reports, and Section V discusses the treatment of payments arrears incurred by governments and government entities. Section VI discusses various techniques that have been applied in eliminating arrears and reviews the experience and the modalities of dealing with arrears in programs supported by use of the Fund's resources. The concluding section proposes a set of operational guidelines.

II. Payments Arrears--Their Causes and Effects

Estimates of outstanding external payments arrears in member countries known to be incurring payments arrears at the end of 1979 are given in Table 1. The data should be viewed with caution since for some countries (primarily those for which the Fund is not currently providing financial assistance) the staff is able to obtain information on arrears only at infrequent intervals. For this reason, data of arrears for some countries are less up-to-date and possibly less reliable than for others. The figures reported in Table 1 relate to total external arrears outstanding. Even with allowance for shortcomings of the data, however, there is no doubt that payments arrears have reached a disturbingly high level in recent years. At the end of 1979 outstanding arrears totaled more than SDR 5 billion, equivalent to 0.5 per cent of total world merchandise exports. Of even more concern is the widespread nature of the problem of arrears. Over the period covered by the review they were reported in one or more years in 26 countries. Illustrating the severity of the problem of arrears, seven of the countries listed in Table 1 would have required more than one half of the proceeds from merchandise exports in 1979 to be allocated to the liquidation of arrears in order to clear the backlog. In some of these countries the proportion was close to 100 per cent or even more. While several countries were able to eliminate arrears during the period, there were a number which remained in arrears throughout the period. Some of the latter countries were among those with difficult balance of payments problems for which the Fund's financial support was being provided to soften the impact of adjustment measures.

Table 1. External Payments Arrears Outstanding, 1975-79 1/

(In millions of SDRs; where applicable, end of period)

	1975	1976	1977	1978	1979	End-1979 arrears as percentage of 1979 exports <u>2/</u>
Bolivia*	--	--	--	--	42	7
Central African Republic*	...	35	39	44	39	39
Chad	9	12	18	22	...	26 <u>3/</u>
Congo*	...	11	23	42	23	9
Dominican Republic	--	11	--	--	17	2
Ghana*	201	259	261	375	303	37
Grenada*	xx	xx	xx	2	1	6
Guinea	50	79	109	138	152	52
Guinea-Bissau	1	6	7	8 <u>4/</u>	...	...
Guyana*	--	--	27	17	20	9
Jamaica*	--	--	22	48	42	7
Madagascar	...	...	...	1 <u>5/</u>	13	4
Mauritania*	--	xx	9	23	15	13
Nicaragua*	--	--	--	31	88 <u>6/</u>	6 <u>3/</u>
Sierra Leone*	4	9	12 <u>7/</u>	22	54	48
Sudan*	68	241	498	610	607	143
Tanzania	--	--	--	50	118	29
Togo*	--	--	16	43	79	34
Turkey*	--	201	1,409	1,523	1,888	100
Uganda*	37	39	21	79	129	38
Zaire*	218	385	671	950	1,118	120
Zambia*	136	223	394	495	350	32
Total	724	1,511	3,536	4,523	5,098	

Sources: Country authorities; and staff estimates.

* Financial program supporting use of the Fund's resources in effect during 1979 or early 1980.

1/ Includes members known to be incurring payments arrears at the end of 1979.

2/ Merchandise exports, f.o.b.

3/ End 1978 arrears as a percentage of 1978 exports.

4/ November 1978.

5/ May 1978.

6/ March 1979.

7/ September 1977.

Note: xx: Arrears less than SDR 0.5 million.

...: Information not available.

--: Payments arrears nonexistent.

Notwithstanding the important changes that have taken place in the international payments system since 1970, recent experience in countries with arrears indicates that the reasons for the emergence of arrears are essentially the same as those set forth in SM/70/139. When payments arrears occur, they inevitably follow a period of sustained pressure on a country's balance of payments that has led to the exhaustion or near exhaustion of foreign exchange reserves. It follows that arrears are often incurred in countries in which external debt servicing has become a major concern for economic management. Underlying this situation in most cases are serious shortcomings in fiscal, monetary, and exchange rate policies. However, the high rates of inflation throughout much of the 1970s, the continued instability of commodity prices, and the generally unfavorable performance of the world economy in the aftermath of the oil price increase of 1973, as reflected in the relatively slow growth of world trade, have contributed to the more widespread incidence of arrears in member countries.

Typically, payments arrears occur in countries which have experienced prolonged difficulties in balance of payments management. The policy response to an emerging imbalance in external payments is usually one in which the authorities react initially by drawing down external reserves and/or intensifying direct or indirect restraints on external trade and payments, in some cases leading to capital flight and to the development of a parallel market for foreign exchange. The resulting loss of reserves, foreign exchange constraints and "leads" in the submission of applications for foreign exchange, in the absence of remedial action, may produce a formal or informal lengthening of the average waiting period for foreign exchange authorization. Experience has shown that the longer the delay in introducing appropriate adjustment policies, possibly including a change in the exchange rate, the greater the difficulty in eliminating payments arrears.

In terms of their impact, payments arrears impose serious disadvantages on both the debtor and the creditor sides, though in differing degrees. The existence of payments arrears inevitably has a damaging effect on the creditworthiness of the debtor country and therefore on its ability to approach international capital markets for new borrowing, with accompanying adverse effects on investment. At times these effects have been found to continue for some time after the arrears, and the factors giving rise to them, have been eliminated. Moreover, the very existence of payments arrears may give rise to speculation about the appropriateness of the prevailing exchange rate, which in turn could lead to adverse market reaction in the form of leads and lags in external transactions, a development that further complicates the task of balance of payments management. Exchange rate expectations generated under such circumstances are apt to have a negative effect on trade and on capital inflows, as well as on foreign exchange sales by the public to the banks. ^{1/}

^{1/} In some developing countries, the problem of arrears is compounded by smuggling activities, with the attendant loss of exchange earnings from exports withheld from the official market.

A country with a history of payments arrears is also likely to experience related additions to costs in its foreign trade. Exporters in trading partner countries are likely to seek added protection against the possibility of delay in settlements by requiring letter of credit financing by importers. Quoted prices for exports to such a country are often raised because of uncertainties about the timing of payments and the duration of arrears, reflecting the variable length of the waiting period. Between exporters and importers (in the case of invisible transactions, remitters and recipients), these circumstances entail the risk of disrupting business relationships and goodwill that may have been built up over a long period. In the area of export credit insurance, undue deferral of payments leads to increased premium costs and even the suspension of such insurance cover. Depending on the magnitude of the arrears problem, the practice of recouping expected losses by mark-ups of prices or other charges could directly or indirectly compound significantly the inflationary developments and balance of payments pressures in the country that is in arrears. Payments arrears are likely to have an additional, undesirable element resulting from their impact on trading partner countries. Unlike generalized exchange restrictions, which are applied on a nondiscriminatory basis before a payments obligation is incurred, payments arrears arise only after the incurrence of a payments obligation. Consequently, additional costs for suppliers may be involved because of uncertainties regarding the terms of settlement. In addition, payments arrears may create the possibility of discrimination. As such they constitute a major disincentive for potential trading partners to enter into commercial transactions with the country in arrears.

III. Problems of Definition, Identification, and Measurement

Governmentally imposed limitations on the availability of foreign exchange which give rise to payments arrears may occur when the authorities formally impose a delay so as to ration foreign exchange--through the establishment of a queuing procedure for exchange applications--or when delays arise on an informal or ad hoc basis. From the standpoint of the Fund, the presence of payments arrears very often is not recognized until some time after their emergence; indeed, on many occasions the first indications that they exist come from reports or complaints by creditor countries, or from statements lodged with export credit agencies. It has been the experience of the Fund that the establishment of formal procedures to settle payments obligations on a delayed basis, according to a program or schedule for their liquidation, usually follows a period in which arrears have accumulated as a result of gradually increasing delays by the authorities in meeting all bona fide requests for foreign exchange.

The conclusions of SM/70/139 contained an unequivocal description of arrears in the nature of exchange restrictions, viz.:

In all cases where payments arrears arise from a governmental limitation on, or interference with, the availability of foreign exchange at the time a payment for a current

international transaction falls due, or with the timely transfer of the proceeds of such transactions, the payments arrears should be treated...as evidence of a payments restriction.

However, uncertainties have surfaced in recent years with regard to the identification of arrears which have the characteristics of the informal or ad hoc payments delays referred to above. Such a difficulty was in fact anticipated in the following statement in SM/70/139, (p. 2):

Not every officially caused delay in authorizing payments or transfers is an exchange restriction, however. Reasonable time for the administrative examination of the bona fides of an application for exchange is an inherent part of exchange control, as is the requirement of compliance with reasonable documentation of exchange applications. These aspects of official control, which are generally incidental to the restriction of capital movements, are part of the normal processing of applications for exchange and do not in themselves give rise to a restriction on current payments and transfers. At times, however, inadequacy or inefficiency in the administration of capital controls has also led to undue delays.

It therefore seems appropriate to reconsider the question of what constitutes an undue delay of payments. Two approaches are possible. Under the first approach any officially caused delay that goes beyond the due date of payment would be treated as an undue delay. This interpretation allows for little or no flexibility, especially since it does not take into account variations in administrative capabilities as between individual members or within any one member country over time. Nor, for instance, does it take account of the nature of certain invisible transactions (e.g., unrequited transfers, profit remittances) for which there may be no due date of settlement, but for which, nevertheless, settlement may be delayed by official action. As a result of these considerations, the use of the criterion of due date as the determinant of the existence of payments arrears is subject to serious limitations.

An alternative and more flexible approach is one that views as undue a delay in payments which exceeds the period reasonably needed to complete the administrative procedures considered necessary to ascertain the bona fides of an exchange application. This period may vary as between members, and may be different for any one member depending on the nature of the application (e.g., for trade, or for invisibles, etc.). Any delay that extends beyond this period, either on an ad hoc basis or as a result of specific governmental action, would be regarded as undue. In applying this approach in a member country in order to ascertain the possible existence of arrears, the staff would need to determine whether the period required to process an application is reasonable in the light of experience in other member countries. This would provide a broad measure against which the extent of delays in payments and transfers in a specific country could be assessed.

The alternative definitions of undue delay discussed above have significance for the sources and availability of data on arrears. Since, at least in the early stages when arrears are emerging, the existing administrative

machinery of a country is not normally geared to collecting detailed data on payments and transfers that have been subjected to undue delay, information on the existence of arrears usually becomes available initially from the creditor rather than the debtor side. The staff has invariably encountered difficulty, especially in the early stages, in verifying the existence of arrears and in measuring their volume. Generally, it is only as arrears increase in size and over time, and as the need for their orderly elimination is recognized, that attention has been given by the debtor country to the systematic collection of data. In many cases, the information on the nature and magnitude of arrears has been collected in the context of programs supported by use of the Fund's resources.

In measuring arrears, experience has shown that the use of data on foreign exchange applications that have been unduly delayed in the approval pipeline tends to exaggerate the value of outstanding arrears. Applicants normally have no incentive to withdraw applications for official exchange, even when settlement of the underlying transactions has taken place through alternative channels, e.g., via a parallel market. Consequently, the demand for foreign exchange reflected in overdue exchange applications often involves, in part, disguised capital outflow. The problem of upward bias to measured arrears could be lessened by requiring exchange applications awaiting approval (in the case of contractual payments, applications held beyond the due date) to be fully backed by counterpart deposits in domestic currency. Such a requirement would serve not only to support the bona fides of applications, but also to weaken the attraction of exporting capital illegally. From the standpoint of the authorities, the withdrawal of liquidity that occurs when the banks are subject to reserve requirements in respect of these deposits, or when the deposits are held in the accounts of the monetary authorities would also be regarded as a useful and desirable supplementary tool of monetary control. When counterpart deposits are sterilized in this manner (i.e., when they are held with the central bank, or when held with a commercial bank and they are made subject to a 100 per cent reserve requirement), the foreign exchange risks may be assumed by the authorities. 1/

1/ Where such deposits are noninterest bearing, or where the foreign exchange needed to liquidate an external obligation is provided at a future date in exchange for the deposit at the rate of exchange in effect on the due date of deposit rather than at the rate of exchange in effect when the deposit was made, the loss of interest income or any additional cost involved in the purchase of foreign exchange may give rise to a significantly different effective exchange rate and may involve a multiple currency practice. The divergence in the effective rate of exchange, however, will be reduced if interest is paid on such deposits; it will be eliminated if the monetary authorities pay sufficient interest, or if they assume the obligations arising from payments arrears and effectively guarantee the exchange rate to be applied at settlement.

IV. Payments Arrears and Exchange Restrictions

When the authorities of a country are responsible for undue delay in approving applications or meeting bona fide requests for foreign exchange for payments for imports or for other current transactions as defined in Article XXX, Section (d) that results in payments arrears, the undue delays are exchange restrictions under Article VIII, Section 2(a) and Article XIV, Section 2. 1/ Arrears on payments relating to the settlement of capital transactions are not restrictions within the meaning of these provisions of the Articles of Agreement. 2/3/

With only a few exceptions, the payments arrears currently existing in member countries and described in Section II above are exchange restrictions subject to the approval of the Fund under Article VIII. In its review of payments arrears in 1970, the Executive Board requested the staff to aim in consultation reports at a more systematic treatment of restrictions on payments and transfers that produce payments arrears, and indicated that the staff should establish whether payments arrears exist by ascertaining whether excessive delays occurred in granting applications for foreign exchange. In addition, the Executive Board stated that when requesting the Fund's approval for the existence of arrears, a member should submit a satisfactory program for their elimination. Approval, when granted, should be only for a temporary period, generally with a fixed terminal date, and should be wherever possible in terms of the level of arrears outstanding.

Since the review of 1970, there has been rather diverse treatment of payments arrears in consultation reports and in the manner in which arrears involving exchange restrictions have been dealt with in decisions under Article VIII and Article XIV. This has been due, in large measure, to differences in the availability of information on arrears in individual countries. The staff can report, however, that since the Second Amendment of the Fund's Articles more attention has been given in consultation reports to the identification of exchange restrictions, including the problem of payments arrears. This has been especially evident since the review by the Executive Board of several staff papers dealing with questions relating to decisions under Article VIII and Article XIV. 4/ In light of this review, the staff

1/ SM/70/139, p. 1.

2/ Article VI, Section 3 states that no member may exercise capital controls "in a manner which will restrict payments for current transactions or which will unduly delay transfers of funds in settlement of commitments, except as provided in Article VII, Section 3(b) and in Article XIV, Section 2."

3/ In the context of programs supported by the use of the Fund's resources, however, performance criteria for the reduction or elimination of arrears are not necessarily confined to payments and transfers for current international transactions.

4/ Decisions Under Article VIII and Article XIV (SM/78/162, 6/19/78); Annual Review of Regular Consultations and Other Issues Related to Article IV (SM/78/287, 12/11/78); and Decisions Under Article VIII and Article XIV (SM/79/88, 4/2/79).

was requested by the Executive Board to adopt a more systematic treatment of restrictive exchange practices in consultation reports. Thus, in the latest Article IV consultation with the members shown in Table 1 (page 4) details of the arrears situation were given in the staff reports and in the papers on recent economic developments; the policy aspects of arrears were dealt with specifically in the staff appraisal. In 17 of the countries identified the arrears involved exchange restrictions. For two of these countries no formal consultations have taken place since the incurrence of arrears. A separate reference to arrears, regardless of whether they were approved, was made in consultation decisions in all but three of the remaining 15 cases involving exchange restrictions.

In the period since the 1970 review, the Executive Board has granted approval for the existence of payments arrears only when the member concerned has submitted a program for the reduction and/or eventual elimination of its arrears. In virtually all such cases, the program has formed part of a comprehensive stabilization program supported by the use of the Fund's resources. Thus, Executive Board approval of existing arrears under Article VIII was given in 8 of the 15 cases involving exchange restrictions mentioned above. In 6 of the 8 Executive Board decisions, there was a specific reference to payments arrears. In the remaining two cases, the Fund's approval was implicit in the general coverage of the approval granted for the member's exchange practices. In all eight cases, the Executive Board fixed a terminal date for the period of approval. Finally, when arrears remained outstanding at the terminal date they were not necessarily approved in the decision taken at the conclusion of the next consultation. For two countries whose payments arrears extended over a period of years, the Fund's approval lapsed and was subsequently reinstated only when a more sustained effort to eliminate arrears was proposed by the member.

V. External Payments Arrears Incurred by Governments

There are payments arrears which do not result from governmentally imposed delays on payments and transfers for current international transactions. Such arrears may arise when a government or government entity whose financial operations form part of the budgetary process fails to meet an external payments obligation. It is difficult to treat these arrears as coming within the jurisdiction of the Fund although their economic effects are the same as those that involve exchange restrictions. Such arrears should therefore be treated as a default. On the other hand, where a public sector entity is clearly independent of the government's day-to-day budgetary controls and has at its disposal domestic currency resources with which to meet its external payments obligations, payments arrears which arise because of an inability to obtain the requisite foreign exchange are evidence of an exchange restriction. The financing arrangements of public entities and the relationship of these entities to the central government therefore need to be examined on a case-by-case basis to arrive at the correct determination.

Another example concerns payments arrears incurred by governments participating in a common central bank. On several occasions recently, Executive Directors have inquired about the treatment of such arrears that occur when the authorities of a country belonging to a regional or joint central bank are unable to meet payments obligations abroad because of an inability to obtain domestic currency with which to purchase needed foreign exchange. This type of arrears has been incurred, for example, by the governments of some of the member countries listed in Table 1 which are also members of the West African Central Bank (BCEAO) or the Bank of Central African States (BEAC). ^{1/} In this connection, questions have been asked as to how these arrears should be dealt with in Executive Board decisions under Article VIII and Article XIV. In these countries arrears have emerged in respect of external payments (as well as domestic payments) because, given the statutory limit on central bank lending to the government, the authorities did not have adequate recourse to domestic currency in order to purchase foreign exchange from the common central bank, even though the central bank, for its part, stood ready to meet all proper requests for foreign exchange. The emergence of payments arrears in these countries to some extent reflects a weakening of the formerly strong discipline that characterized government financial operations. Several Fund members belonging to a regional central bank and incurring external arrears of this type have received financial assistance from the Fund in support of adjustment programs which have sought, inter alia, to eliminate arrears on both domestic and foreign payments. The payments arrears described here have not been treated by the Fund as evidence of exchange restrictions and have been considered not to fall within the Fund's approval jurisdiction under Article VIII. Rather, they have been dealt with as a default of the governments concerned. When reviewing members' policies in connection with Article IV consultations, some Executive Directors have observed that while in such cases the need to eliminate payments arrears is discussed explicitly in the staff appraisal of the consultation report and in the Chairman's summing up, the decisions concluding the Article XIV consultation may include a commendation to the member for maintaining an exchange system free of restrictions. This apparent inconsistency arises because these decisions are confined to matters coming within the jurisdiction of the Fund.

There is no doubt that payments arrears incurred by governments as a result of default are as damaging to a country's credit standing and to the effective functioning of the world's payments system as the other forms of payments arrears discussed earlier in this paper. For this reason, it is appropriate for the Fund to urge members incurring such arrears to remove them at the earliest opportunity, irrespective of the nature and origin of the arrears. Consultation reports should therefore continue to take note of the existence of arrears arising from default. This approach is consistent with that accorded to arrears of member countries that are treated as evidence of exchange restrictions within the meaning of Article VIII.

^{1/} The problem has also emerged in at least one other member country belonging to a regional monetary arrangement.

VI. Elimination of Payments Arrears

For any country with external payments arrears, a program to restore equilibrium to the balance of payments should give high priority to the speedy elimination of arrears and the restoration of a system of prompt payments. Various techniques have been adopted by members to eliminate arrears, often within the context of programs supported by use of the Fund's resources. The management of arrears and the ability of the authorities to integrate the phased reduction of arrears with overall financial policies are facilitated when arrears are mandatorily centralized by the monetary authorities (central bank). Under such arrangements, when arrears are represented by deposits in domestic currency held as counterpart funds, any reduction in arrears is automatically reflected in a drawdown of these deposits. A similar result may be achieved if such deposits are held with commercial banks in blocked accounts. However, if arrears are not treated in this manner, and applications for foreign exchange in respect of delayed payments are not backed by the domestic currency counterpart, arrears cannot be adequately monitored (as indicated in Section III), and the results of a program to reduce and eliminate them may be much less assured.

Another aspect of procedures to eliminate arrears concerns the method of settlement of individual outstanding payments obligations. The choice will depend on a range of factors, including the nature (i.e., whether current or capital) and extent of the arrears, the overall balance of payments problem, and the institutional arrangements in the country concerned. One approach to the elimination of arrears gives primacy to the first-in first-out (FIFO) principle, and can be supported on the grounds of equity since it seeks, in an orderly manner, to eliminate arrears chronologically in the order in which they were incurred. A major drawback of this system is that it does not immediately lead to the restoration of a system of prompt payments for current obligations; it may therefore serve to dilute the country's effort to regain a good standing in the international capital markets. Furthermore, adherence to the FIFO method may be impractical because of the lumpiness of individual transactions.

A second broad approach is one that aims at the immediate restoration of prompt payment of current obligations and the avoidance of new arrears, while stretching out the settlement of existing arrears. A variant of this approach involves a priority (or discretionary) reduction of arrears depending on the type of transaction, e.g., import payment obligations (perhaps with a further breakdown according to essentiality) or debt service obligations. This method has the unsatisfactory feature of requiring different waiting periods for the settlement of payments arrears according to the type of transactions involved. Yet another method is the use of a uniformly applied schedule by which the same percentage reduction is applied progressively, across the board, to all existing arrears as computed on a given date: for example, a goal of eliminating arrears during a specified period could be pursued in terms of reducing the amount outstanding in even monthly steps. Alternatively, a maximum waiting period could be specified beyond which all legitimate payments applications would be eligible for automatic approval,

the objective being to reduce progressively, in line with the evolution of the overall external payments position, the length of the waiting period, up to a point where payments arrears are fully liquidated. A shortcoming of this technique is that it constricts the ability of the authorities to maintain control over either the level of arrears outstanding or the level of gross external reserves. ^{1/} In summary, there is a wide range of techniques available to address the problem of eliminating payments arrears and the choice in any one country will depend on the circumstances of the member and its institutional arrangements. Regardless of the method chosen, a systematic monitoring of progress is desirable. In the discharge of obligations relating to payments arrears, it is important that settlements to creditor countries be made on a nondiscriminatory basis.

In its review of payments arrears in 1970, the Executive Board emphasized that Fund financial assistance to members with payments arrears should be granted on the basis of performance criteria or policies with respect to the treatment of arrears in recognition of their status as payments restrictions. Paragraph 4 of Executive Board Decision No. 3153-(70/95) reads as follows:

Fund financial assistance to members having payments arrears should be granted on the basis of performance criteria or policies with respect to the treatment of arrears similar to the criteria or policies described in the preceding paragraph for the approval of the payments restrictions. In general, the understandings should provide for the elimination of the payments arrears within the period of the stand-by arrangement. Such understandings should be based on the concept of a given level of payments arrears and should be reflected in the performance criteria included in stand-by arrangements in the higher credit tranches. To support the policies designed to deal with arrears the letter of intent should include a statement that there would be no imposition of new restrictions or increase in the level of delayed payments. Where Fund financial assistance is being provided, but only through the first credit tranche, the adoption of a viable program directed toward the elimination of the payments arrears should be an important factor in considering whether the country was making reasonable efforts to redress its international financial situation. ^{2/}

As indicated in Table 1 above, 16 of the 22 countries with payments arrears at the end of 1979 had financial programs supported by use of the Fund's resources during 1979 or early 1980; all of these programs included

^{1/} To meet this problem, a recent program with a Fund member provided that, during a given period, the authorities would not allow gross official international reserves to rise beyond a specified level unless all payments arrears have been eliminated (see Guyana - Use of Fund Resources - Extended Fund Facility, EBS/80/155, 7/11/80, p. 32).

^{2/} IMF, Selected Decisions of the International Monetary Fund and Selected Documents, 8th issue, p. 143.

understandings or targets with respect to the reduction of arrears as well as to the avoidance of any new arrears during the program period. For programs relating to the first credit tranche, letters of intent generally included a statement by the member that arrears would not exceed a certain level, or that they would not be allowed to recur during the program period. In most upper credit tranche programs, performance criteria provided for a phased reduction of arrears. Furthermore, the elimination of arrears was generally regarded as a very significant step to be taken by the member in reducing its reliance on exchange restrictions. In one important respect, however, the objectives specified by the Executive Board in 1970 have proved difficult to meet. In a number of countries with Fund supported programs it has not been possible to aim at the complete elimination of arrears over the program period, reflecting the large amounts outstanding and the continuing pressures on the balance of payments which severely limited the amount of exchange available for the liquidation of arrears. In a number of cases, there were also problems of obtaining adequate data on arrears and of establishing effective institutional arrangements for their elimination. This experience has shown that a more flexible approach may be preferable whereby members will not be expected to eliminate arrears over the life of a one-year program, although normally it should remain an objective of programs covering two or three years. As a minimum effort, however, members would be expected to observe a requirement to avoid any further increase in outstanding arrears.

In any program to phase out arrears on payments to service external debt, the following additional issues arise. Such arrears usually relate to overdue payments on external public debt, covering both interest and principal. A number of the countries with arrears shown in Table 1 had arrears relating to official debt obligations, and for some of them, progress in eliminating arrears has been dependent, in part, on their success in arranging for debt rescheduling. In recent years there has been increasing resort to the funding of arrears through such arrangements by rescheduling debt payments under a multilateral arrangement such as the Paris Club, or by way of a bilateral rescheduling of arrears. The rescheduling of debt obligations has been associated with several recent programs supported by use of the Fund's resources. While permitting the member a measure of debt relief, such reschedulings in very difficult cases also allow the country concerned to re-enter the capital market and to achieve an increased import flow to assist economic recovery. Issues relating to debt renegotiation will be dealt with in a forthcoming staff paper.

VII. Conclusions

1. In the decade since the Executive Board last reviewed the Fund's policies and procedures on payments arrears, there has been a substantial increase in the number of countries incurring payments arrears and in the total amount of arrears outstanding. The widespread nature of the problem of arrears is a manifestation of the sustained payments pressures and resulting adjustment difficulties experienced by many countries in recent years. The Fund's concern with these developments stems not only from the harmful effects on

creditor countries and their deleterious consequences for the credit standing of the members incurring them, but also from their injurious effects on the smooth functioning of the international trade and payments system.

2. Through the exercise of its approval jurisdiction, the Fund's policies on payments arrears are concerned with exchange restrictions within the meaning of Article VIII, Section 2(a) which arise from governmentally imposed delays on payments and transfers for current international transactions. Because of the damaging effects of arrears on the international trade and payments system, the Fund does not grant approval to payments arrears which are exchange restrictions within the meaning of Article VIII, Section 2, except where the member has presented a program for the reduction and/or the eventual elimination of such arrears. When payments arrears are incurred by a government or by a government entity, the financial operations of which clearly form part of the budgetary process, and in those cases in which arrears arise because a country belonging to a common central bank is unable to obtain domestic currency in order to purchase required foreign exchange, the arrears should be treated as defaults and not as exchange restrictions within the meaning of Article VIII. In the settlement of payments arrears, member countries should observe the principle of nondiscrimination as regards creditor countries.

3. The Fund's policies on payments arrears are also concerned with their treatment in the context of stabilization programs supported by use of the Fund's resources. In these programs, member countries are expected to take steps to reduce and eventually eliminate payments arrears relating to capital transactions as well as to payments and transfers for current international transactions. In formulating policy guidelines in these programs, the staff will continue to be guided by the approach set forth in the Executive Board decision of 1970 (Decision No. 3153-(70/95)), as quoted on pp. 12. This approach will also be followed with respect to payments arrears arising from default. The technique chosen by a member to reduce outstanding arrears will reflect its institutional arrangements, as well as the magnitude of the arrears and the severity of the balance of payments problem. When payments arrears are large in relation to a member's available foreign exchange resources, it may not be possible to aim at the elimination of the arrears within the program period. Special arrangements may be needed for the renegotiation of outstanding debt obligations when debt problems are particularly severe. Depending on the member's circumstances and the length of the program, it may not be possible, in the early stages of a program, to reach an understanding with the member that goes beyond requiring the avoidance of any further increase in arrears.

4. There has at times been uncertainty as to the circumstances in which a delay resulting from a governmental limitation on, or interference with, the availability of foreign exchange would constitute an undue delay and thereby give rise to payments arrears. A flexible and pragmatic approach would seem to be appropriate, whereby an undue delay would be defined as one that exceeds the period reasonably needed to complete the administrative procedures required to establish the bona fides of an application for foreign exchange, having regard to the circumstances of the member concerned.

Mr. Funch

cc: Mr. Funch

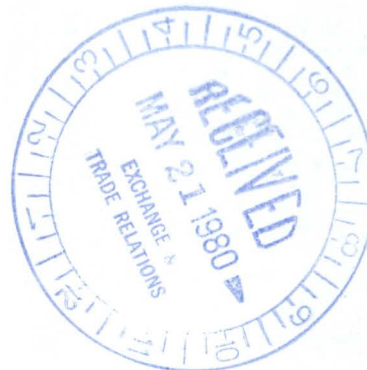
INTERNATIONAL MONETARY FUND

May 20, 1980

TO : Mr. Subimal Mookerjee
FROM: George P. Nicoletopoulos *G.P.N.*
Subject: Draft Paper on Review of Fund Policies and
Procedures on Payments Arrears

You will be interested in the attached memorandum from Ms. Lachman on the draft paper on payments arrears that you have sent to me recently. Let me know if you wish us to pursue the matter.

cc: Ms. Lachman





Office Memorandum

TO : Mr. George P. Nicoletopoulos

FROM : Philine R. Lachman *PL*

SUBJECT : Draft Paper on Review of Fund Policies and Procedures on Payments Arrears

DATE: May 19, 1980

The following are my comments on the substance of this paper. At this stage comments on the details of the drafting are not presented.

1. There is no explanation why the paper is produced at this time. This question is more than academic in view of the actual and expected serious payments difficulties of most developing members.

2. The statement (page 6) that the very existence of arrears creates a prima facie presumption against the appropriateness of the exchange rate might be supplemented with a reference to the recently adopted approach under which the Fund should also look to remedial measures other than depreciation.

3. There is repeated reference to the Fund's approval jurisdiction under Article VIII and Article XIV. The Fund does not approve restrictions under Article XIV; restrictions may be continued or adapted under Article XIV without the need for approval. In all other cases, they are subject to Article VIII.

4. On the basis of "Legal Aspects of Multiple Currency Practices Under the Second Amendment" it is argued that the requirement of a local currency deposit does not involve a multiple currency practice when the monetary authorities assume the exchange risk instead of the debtor, because the absence of interest is not a factor in the determination of the effective rate. What the legal paper stated was:

"Distinctions may have to be made in relation to deposits connected with payments arrears that assure the depositor that foreign exchange will be provided to him in the future in exchange for the deposit at the rate of exchange in effect when the deposit was made. If the deposit does not bear interest, the absence of interest will be an additional cost, but this arrangement has many aspects of a forward transaction and, particularly where the exchange rate for the local currency is fluctuating, the loss of interest may be more than offset by a change in the exchange rate. It may be difficult in assessing the monetary cost of measures such as advance deposits to establish what should be regarded as the effective rate because of the different factors that must be taken into account. The legal result will depend, nevertheless, on the determination of the effective rate in the circumstances of each such case."

There is no indication of the date as of which governments should effectively guarantee the exchange rate "to be applied for settlement". Also, it is not explained why governments lacking foreign exchange should relieve private parties of the exchange risk.

5. The proposition that the payment of the counterpart in domestic currency by a debtor would discharge the debtor's liability vis-à-vis the creditor has no basis in law.

6. With respect to inability of the government of members belonging to a common central bank to purchase foreign exchange because of lack of access to the domestic currency (Section V) there is no discussion of the distinction between default on the part of the central government, default by official entities that enjoy a greater or lesser degree of independence, and default on the part of private enterprises. That distinction has an effect on the finding that in any particular case there exists a default rather than an arrear. The proposal that defaults by countries belonging to a common central bank be treated as exchange restrictions because the contrary solution would mean that these countries enjoyed an insufficient measure of sovereignty to belong to the Fund is utterly unconvincing.

7. The terms "payment arrears", which are exchange restrictions under the 1970 Decision, "debt arrears", and "debt-related arrears" are used interchangeably. It would be preferable to use the same term throughout, unless it is intended to make distinctions.

8. The reference in paragraph 4 of the conclusions that where appropriate (when would it not be?) rescheduling of external debt would contribute to the early restoration of prompt payments fails to refer to different categories of debts that may be in arrears, i.e., public, publicly guaranteed, and private debts. If the subject is retained in the conclusions, it should be discussed in the body of the paper.



Office Memorandum

J. Watson
cc: Mr. P. N. Ncheraghan
JAN 14 1980

TO : The Managing Director
FROM : Ernest Sturc *ES*
SUBJECT : Paper on Payments Arrears

Mr. Finch

DATE: January 14, 1980

*please see page 2, this was
among the papers which the
Managing Director took with him
to Africa. Max Watson, Feb 50*

We are preparing a paper for the Executive Board reviewing the Fund's policies and procedures on payments arrears. The last review took place almost 10 years ago. In the period since then, unfortunately, we have witnessed a substantial increase in the incidence and severity of the problem of arrears. In concluding its review in 1970, the Executive Board expressed concern at the adverse effects of payments arrears on the smooth functioning of the international monetary system and on the creditworthiness of countries incurring them. Noting that undue delays in the availability or use of exchange for current international transactions were exchange restrictions under Article VIII or Article XIV, the Executive Board in concluding its review: (a) instructed the staff to aim in consultation reports at a more systematic treatment of exchange restrictions involving payments arrears; (b) delineated the circumstances in which the Fund would grant approval for such restrictions; and (c) specified the manner in which arrears should be treated in programs for members with payments arrears and seeking access to the Fund's resources.

The spread of payments arrears in recent years, and their unsettling effects on the world's trade and payments system, have been highlighted in several of the Fund's Annual Reports on Exchange Arrangements and Exchange Restrictions. Nevertheless, it seems essential that the Fund's policies in dealing with this disturbing impediment to international payments be reexamined. This is the intent of the forthcoming paper on arrears, which will provide Executive Directors an opportunity to reevaluate the guidelines described above, and possibly to formulate new ones in light of recent experience. The paper will pay particular attention to problems of definition so as to provide us with possibilities for the early detection and speedier assessment of the volume of arrears, and will discuss what policy improvements could be devised to assist a member to eliminate arrears at an early date. Executive Directors have, on occasions, referred to some of these aspects of policy in the context of their consideration of staff reports on individual member countries.

A particularly troublesome issue, and one that I would like to bring to your attention, concerns the spread of payments arrears in countries which participate in common central bank arrangements. Of special relevance in this context are Fund members which belong to the West African Central Bank (BCEAO) and the Bank of Central African States (BEAC). What we have witnessed in some of these countries in recent years is an apparent weakening of the formerly strong internal discipline over fiscal operations, conditioned by the agreements of the Franco-zone countries with France. As a result of the recent developments, there has emerged a conflict which, inter alia, has led to the existence of payments arrears by the government because of an inability to provide domestic means of payments, although the common central bank would have been willing at the surrender of domestic currency to provide promptly any


requested foreign exchange. An important question is to what extent the common central bank remains an effective tool for the purposes of balance of payments management of individual countries. A related issue, of significance for the Fund's approval jurisdiction under Article VIII, is whether the arrears on external payments which have emerged in such cases are also legally exchange restrictions. Their impact on the functioning of the international trade and payments system is the same as that caused by "common" arrears. The Fund is committed to supporting regional trade and payments agreements and has done so consistently in the past. Given the special relationship between the two common central banks, their members, and the French Treasury, I would appreciate your guidance on how to deal with this problem. It seems to us that, for one reason or another, fiscal discipline in some of these member countries has slipped badly, and that the adjustment effort has become concentrated, through the common central banks, on a tightening of credit policy especially in regard to government borrowing. In this regard, the views of the French authorities would be helpful. Should we approach them before writing this issues paper, or do you think that it would be preferable to let our analysis lead us where it may, possibly to a further weakening of the cohesion of these groups of countries?

of course
JL

cc: The Deputy Managing Director
✓ Mr. Watson



Office Memorandum

TO : Mr. Sturc
FROM : John B. McLenaghan 
SUBJECT : Payments Arrears

DATE: June 7, 1979

As requested at this morning's meeting, I am attaching a copy of my memorandum of December 1, 1978 on this subject, and the accompanying outline of a proposed paper on payments arrears.

Attachment

cc: Mr. Finch
Mr. Palmer
Mr. Mookerjee
Mr. Kanesa-Thanan (o/r)

Mr. Sturc

December 1, 1978

John B. McLenaghan

Paper on Payments Arrears

Following our discussion on the list of staff studies by the Exchange Restrictions Division, it was agreed that we would produce an outline of a paper which would address the main problems which have recently emerged in the area of payments arrears. Mr. Baumgartner, whose work on Turkey has involved him in detailed analysis of a number of aspects of arrears, has now prepared the attached note on the broad questions which could be dealt with in a staff paper. I hope to discuss this with you following my return to Washington in the latter part of December.

Attachment

cc: Mr. Finch
Mr. Palmer
Mr. Mookerjee
Mr. Kanesa-Thanan
Mr. Osundade
Mr. Baumgartner

100. M. Baumgartner

DRAFT
UBaumgartner:mm
November 28, 1978

This paper represents an effort to identify the principal issues related to payments arrears and to provide some preliminary suggestions for a Board paper and/or guidelines for the staff on arrears.

The emergence of arrears on a large scale in an increasing number of countries seems to warrant a review--not necessarily a change--of Fund policy on arrears including an assessment of programs supported by stand-by arrangements with countries experiencing substantial payments arrears. The policy paper on arrears of July 1970 (SM/70/139) still seems to be generally adequate. As regards policy issues, it does, however, not cover the problem of arrears versus default and is rather vague and not always fully consistent with respect to the question of what constitutes "undue delay." Furthermore, SM/70/139 does not discuss the manifold technical problems that have arisen as a result of arrears and that have to be dealt with in stabilization programs.

The Executive Board might be interested in a paper on

- (1) principles of Fund policy with respect to arrears;
- (2) causes of arrears, restrictive practices and consequences of arrears;
- (3) treatment of arrears in stand-bys.

Since arrears have given rise to a number of complex problems in stand-bys which might be too technical to be included in a Board paper, a technical guidance note for the staff may be desirable.

1. General issues

a. Basic definition

The following three paragraphs are quotations from various sections of the Board paper on arrears of July 1970 (SM/70/139). They have been reordered in order to present all definitional matters in concise form.

"Undue delays in the availability or use of exchange for current international transactions that result from a governmental limitation give rise to payments arrears and are payments restrictions under Article VIII, Section 2(a) and Article XIV, Section 2." 1/

"The term payment arrears covers undue delay in connection with both payments (i.e., the financial settlement of obligations) and transfers (i.e., the conversion of proceeds of payments)." 2/

"Payments arrears" arise as a consequence of a government limitation on, or interference with the availability of foreign exchange at the time a payment for a current international transaction falls due. "Transfer arrears" arise when a government limitation on, or interference with, the availability of foreign exchange prevents the timely transfer of the proceeds of a current international transaction. 3/

1/This definition of "transfers" does not (and should not) coincide with the BOP definition of "unrequited transfers" which are "the provision or receipt of economic values without a quid pro quo." However, arrears on unrequited transfers are unequivocally covered by the basic definition of arrears (in the first paragraph) as undue delays in the availability or use of exchange for current international transactions. Current international transactions include unrequited transfers. This point might have to be mentioned in a Board paper or guidance note for the staff. 7

The definition of arrears in the three paragraphs above seems to be adequate. However, the term "conversion" in the second paragraph is more narrow than the definition of transfer arrears in the third paragraph. To avoid confusion

1/ SM/70/139, page 7, last paragraph.

2/ SM/70/139, page 1, first paragraph.

3/ SM/70/139, page 8, second paragraph.

the explanations of payments and transfer arrears in the second paragraph shown in parentheses could best be omitted, because the third paragraph provides a better and sufficient explanation of the terms "payments arrears" and "transfer arrears." "Payments arrears" in the third paragraph could perhaps be called "payments arrears in a narrow sense."

b. Nature of the government limitation

The government limitation or interference may be formalized, as for instance compulsory waiting periods for exchange, or informal or ad hoc.

The paper could provide examples of the various types of limitations (see SM/70/139, page 3, second paragraph).

c. Arrears and restrictions

Payments arrears are payments restrictions under Article VIII, Section 2(a) and Article XIV, Section 2. The language sometimes used in the Board paper of July 1970, some Decisions, and other papers refers to arrears interchangeably as cause, consequence, reflection or evidence of payments restrictions. Formulations should not depart from the legally correct view that government limitation or interference causes undue delays which in turn gives rise to arrears which are (constitute) payments restrictions. There seems to be little merit in pursuing the issue of whether arrears result from or cause restrictions.

The policy issue of when to approve or withhold approval of arrears needs to be clarified.

d. Definition of current international transactions (Article XXX d) and related issues

(1) delineation of pure capital transactions

(2) contractual obligations versus quasi-contractual or moral obligations (remittances, etc.)

(3) overdue claims of foreign banks (reimbursement claims, overdrafts, overdue bankers' acceptances, etc.)

In principle, all bona fide applications for foreign exchange which are subject to governmental limitations resulting in undue delays in the availability or use of foreign exchange should be considered. The bona fides of each application would have to be scrutinized carefully and only applications for which the local currency counterpart has been deposited should be included. Capital flight should be prevented mainly through controls on the transaction and not on the payment. Overdue claims of foreign banks clearly related to current transactions, such as overdue bankers' acceptances and reimbursement claims, should be included in arrears. Similarly, overdue applications for remittances and other unrequited transfers should be considered arrears provided local currency deposits have been made.

e. Default and arrears due to shortage of local currency

(1) Does the nonobservance of government obligations give rise to arrears (i.e., does it constitute a restriction) or is it a case of default? In other words, is the legal status of the debtor a criterion to be taken into account?

(2) Does the nonavailability of local currency to the public sector cause arrears or constitute default? Question (2) differs from question (1) insofar as (2) presumes the willingness of the government to fulfill its obligation.

If one follows the definition of arrears as "government limitation of the availability or use of exchange" problems (1) and (2) should be considered cases of default. In order to decide the issue of default versus restriction, institutional arrangements such as the access to foreign exchange and local currency by the government would need to be looked at carefully. In this context multi-country central bank arrangements are particularly relevant.

There is also the problem of defining government and public sector (state economic or nationalized enterprises should be excluded).

The restrictions clause in stand-by should perhaps be expanded to cover some cases of default.

A further issue is the nonpayment of debts for (pretended or genuine) security reasons.

f. Undue delay

SM/70/139 is not clear on the issue of what constitutes undue delay.

While in one passage some delay, provided it does not exceed a reasonable time for the administrative examination of the exchange application, is condoned; ^{1/} the conclusions recommend that "in all cases where payments arrears arise from a governmental limitation or interference with the availability of foreign exchange at the time a payment for a current international transaction falls due, or with the timely transfer of the proceeds of such transactions, the payments arrears should be treated ... as evidence of a payments restriction" ^{2/} On the other hand, the staff is being told "to establish ... whether there has been a substantial delay beyond that usually required for ascertaining the bona fides of exchange applications or the time that can be regarded as normally required for the administrative processing of applications for exchange." ^{3/} Finally, SM/70/139 recommends that the "maximum permissible delay" be specified in programs for elimination of arrears. ^{3/} This makes for excessive ambiguity. The ambiguity might be reduced (though perhaps not fully eliminated) by establishing the due date as the principal criterion for undue delay. While the due date is relatively easy to ascertain in the

^{1/} SM/70/139, page 2, second paragraph.

^{2/} SM/70/139, page 8, second paragraph.

^{3/} Ibid.

case of payment obligations, a precise due date may be difficult to establish in the case of unrequited transfers. In addition to the criterion of the due date, consideration might be given in practice to the normal time required for the administrative processing of applications for exchange in the ordinary course of business including the ascertaining of the bona fides of the application. For this purpose one would have to examine the administrative procedures involved in the different modes of settlement (letter of credit, draft, banking transfer, etc.) for different types of current transactions (trade, remittances, profits, dividends, amortization, and interest).

g. Cause of the undue delay

- (1) Foreign exchange problems
- (2) Local currency problems
- (3) Inefficient administrative policies
- (4) Other factors (e.g., political)

2. Practical issues

a. Determination of the level of arrears

This issue is related to the definition of "undue delay" and the transactions on which payments restrictions (arrears) under Article VIII, Section 2(a) and Article XIV, Section 2 can arise.

In principle the arrears figure should be the aggregate of amounts received by the authorities in local currency countervalue against which the authorities have failed to provide or transfer foreign exchange without undue delay and where there is a bona fide current transaction.

The need for a local currency deposit reflects the principle of "exchange" and is also a requirement of economic policy.

In practice the determination of the level of arrears will be impeded by

- (1) Failure, in particular, of public entities to put up required deposits.

(2) Applications for foreign exchange for speculative reasons (e.g., the payment has already been made through the black market, but deposits remain outstanding to finance another transaction). The requirement of local currency deposits provides some safeguard against excessive amounts of speculative applications.

(3) Problems in separating overdue applications from other requests.

b. Other issues related to deposits

Arrears should be treated as foreign liabilities of the central bank and deposits should be kept in the central bank. This ensures the absorption of liquidity and facilitates monitoring (the BOP would show arrears "below the line" to the extent that deposits were made in the central bank; other arrears would have to be shown "above the line").

The deposit requirement raises the question/whether an exchange rate guarantee should be provided by the central bank and creates the possibility of multiple currency practices.

The need for deposits and their centralization in the central bank is obviated if on the due date of the transaction the central bank debits the deposit account of the commercial bank through which the request was put forward and credits a liability item titled foreign exchange for future delivery. The commercial bank debits its account with the central bank, credits an asset item titled foreign exchange purchased for future delivery, debits the deposit account of the applicant and credits a liability item, foreign exchange sold for future delivery. This system also provides an effective exchange rate guarantee and avoids the possibility of multiple currency practices.

3. Arrears and stand-by arrangements

a. Primary objectives and corresponding provisions in stand-bys

(1) Elimination of arrears through (a) funding of arrears and re-scheduling of payments through a multilateral arrangement (e.g., Paris Club,

or arrangement with foreign banks); and (b) unilateral rescheduling of arrears not covered by multilateral arrangements (e.g., arrears on debts without guarantee by a foreign export credit guarantee institution) to be supported by a phased ceiling (performance criterion). 1/

(2) Early regularization of all current transactions; ideally, there should be no new arrears from the beginning of the stand-by period (performance criterion).

b. Main practical problems often encountered

(1) Difficulty of determining the true level of arrears and large amount of missing local currency deposits.

(2) Multilateral consolidation agreement yet to be concluded.

(3) Inevitability of some new arrears in the early phase of the stand-by.

(4) Arrears/^{sometimes} constitute a relatively high proportion of the money supply and deposits fall substantially short of true arrears.

c. Possible interim solutions to the problems in b.

(1) Specification of maximum time period for making deposits or effecting forward sales of foreign exchange (performance criterion).

(2) Imposing a phased ceiling on the net stock of arrears (performance criterion). The planned speed of running down the arrears could vary with the suspected amount of speculative applications. It can be expected that a tight monetary program would lead to the early withdrawal of such deposits. (Withdrawals should not be impeded since it is important to determine the true level of arrears but provision must be made for adjusting the credit ceiling for any withdrawals)

1/ SM/70/139 states that arrears should be eliminated within the stand-by period (page 8, last paragraph). However, in many cases the total elimination of arrears within the stand-by period is not realistic.

(3) If the level of arrears cannot be established, a minimum requirement would be that no new arrears are to emerge (performance criterion). This clause is, of course, difficult to enforce and recourse might have to be taken to information from abroad.

(4) Specific review clause (performance criterion) which could be applied in combination with (1) - (4).

d. Other issues to be covered in stand-bys

(1) Provisions against circumvention of credit ceilings in the context of rescheduling of arrears (ceiling adjustments/classification of consolidated arrears as foreign liabilities, or other provisions for sterilization of counterpart funds).

(2) Exchange rate guarantee on deposits.

(3) Multiple currency practices possibly resulting from deposit arrangements and approval of multiple currency practices.

(4) Interest on arrears (who is liable: Treasury or original debtor?).

(5) Arrears in respect of capital transactions.

(6) Method of reducing arrears (e.g., first-in-first-out, or proportional reduction of each claim).

(7) Nondiscriminatory reduction of arrears. This is difficult to monitor and should not be made a performance criterion. Some discrimination is inevitable. General restrictions clause in stand-bys covers discriminatory practices that give rise to restrictions (the clause would perhaps need to be reviewed to cover this aspect more explicitly?).

4. Case studies (Causes and consequences of emergence of arrears)

a. Causes (e.g., domestic economic policies, external shocks)

b. Review of restrictive policies

c. Consequences

- (1) Interruption of supplies
- (2) Mark-up of import prices
- (3) Increase in terms of trade credits and termination of guarantees provided by foreign export credit guarantee organizations
- (4) Multiple currency and other discriminatory practices
- (5) Bilateral payments and barter arrangements

d. Efforts to solve the problem of arrears and the Fund's role.



Office Memorandum

M. Brian
see me on this
please
5

TO : Mr. Sturc

DATE: May 17, 1979

FROM : E. Elmholt *EE*

SUBJECT : Multiple Rates and Deposits Connected with Payments Arrears

In ~~SM/79/127~~ (5/15/79) there is a paragraph about multiple rates and deposits connected with payments arrears (page 15).

Distinctions may have to be made in relation to deposits connected with payments arrears that assure the depositor that foreign exchange will be provided to him in the future in exchange for the deposit at the rate of exchange in effect when the deposit was made. If the deposit does not bear interest, the absence of interest will be an additional cost, but this arrangement has many aspects of a forward transaction and, particularly where the exchange rate for the local currency is fluctuating, the loss of interest may be more than offset by a change in the exchange rate. It may be difficult in assessing the monetary cost of measures such as advance deposits to establish what should be regarded as the effective rate because of the different factors that must be taken into account. The legal result will depend, nevertheless, on the determination of the effective rate in the circumstances of each such case.

I have some difficulty in following the argument that if the deposit does not bear interest, the absence of interest will be an additional cost.

If an importer, as an example, had received the exchange at the time of maturity of the letter of credit, he would have handed over local currency to pay for the foreign exchange. Since he does not receive foreign exchange right away when payments are in arrears, he makes a deposit and receives foreign exchange when available. The fact that he does not receive interest on the deposit has not in any way raised his cost of acquiring exchange: in one case he would have handed over the local currency right away, in the other case he would hand over the local currency some time later. It could even be argued that if he received interest on the deposit, he would have paid less for the foreign exchange than if he had been able to buy the exchange right away. The fact that he has had a blocked deposit has not in any way deprived the importer of financial resources which under normal circumstances would have been reduced at the time of maturity of the letter of credit.


It is also said that where the exchange rate for the local currency is fluctuating, the loss of interest may be more than offset by a change in the exchange rate. This would indeed be a most unusual occurrence as it would require that the local currency would have appreciated between the time the deposit was made and the foreign exchange was made available, and that in a case where the country was suffering from a shortage of exchange, most often because the currency is overvalued and, therefore, most unlikely to appreciate.

I would, most reluctantly, agree that prior import deposits (particularly if in excess of 100 per cent of the value of the imports) be considered part of the cost of acquiring exchange and, thus, give rise to multiple rates. But deposits against arrears are of a very different nature and it would be most difficult to make a finding that the existence, or lack of interest on such deposits would give rise to multiple rates. In any case, the Fund would have jurisdiction as the existence of arrears give rise to restrictions on current payments. Why would we want to adapt the concept of multiple rates to acquire the jurisdiction that we already would possess?



Office Memorandum

TO : Mr. Sturc

FROM : John B. McLenaghan 

SUBJECT : Payments Arrears

DATE: February 6, 1979

I refer to Mr. Kanesa-Thasan's memorandum of January 30 on this subject, and our earlier discussion on a proposed paper on payments arrears. Mr. Kanesa-Thasan has raised again the problem of arrears by governments in making payments to foreign suppliers, including the special case of such arrears by governments having a common regional central bank. In this connection, mention can also be made of arrears on government debt obligations abroad, and of their status as restrictions under the Fund's approval jurisdiction.

There has clearly been heightened interest by some Executive Directors (especially Mr. Ruding) in the general question of arrears both as regards individual countries, and as reflected in the Executive Board's discussion on Part One of the ARER last year. In my view there will be an even sharper focus on this question in the Executive Board discussion on the Report now in preparation and it seems unlikely that the review by the Legal Department as proposed by Mr. Kanesa-Thasan could be completed in time to be useful for the ARER. Moreover, there is a good case for having a more wide-ranging review of a number of issues relating to arrears. Perhaps the best approach at this stage is to ask Legal to provide a preliminary determination on the status under Article VIII of payments arrears incurred by governments, as described above, with the subject to be taken up in a comprehensive review of arrears at a later stage.

cc: Mr. Kanesa-Thasan



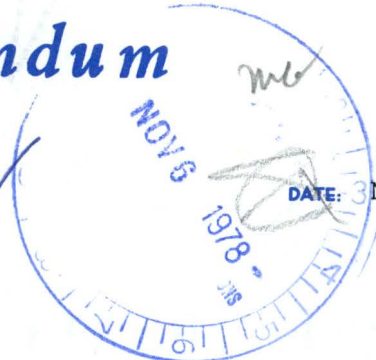


Office Memorandum

TO : Mr. Sturc

FROM : S. Kanesa-Thasan. *SK*

SUBJECT : Payments Arrears



DATE: 3 November 7, 1978

Further to our discussion a few days ago, I summarise below my conclusions on the question of staff work on arrears.

1. The 1970 staff paper defined payments arrears, characterised them clearly as restrictions on current international transactions, and dealt with their treatment by the Fund. The resulting Board Decision clearly spelt out the procedures to be followed in Fund treatment of arrears in the context of its approval jurisdiction of restrictions on current transactions and of the use of its resources.^{1/} In light of the actual experience with the implementation of the Decision, the procedures prescribed appear to be rather stringent. However, after reflection, I do not see how else the Decision could have been framed, if the Fund is to be serious about executing its responsibilities under the Articles of Agreement.
2. Thus, the problem is not with the 1970 Decision, but that its implementation has been rather ineffective for the following reasons:

- (a) Practical problems encountered in identifying and quantifying arrears.

A special problem which has emerged in this area is whether arrears in government payments in BEAC and BCEAO countries in Africa arising from the nonavailability of domestic currency due to limits of central bank credit to the Government, should be treated as payments arrears in the context of Fund's approval jurisdiction. Hitherto the Legal Department has held that they do not constitute such arrears. This is an excessively formalistic view and ignores the basic policy option that the authorities have of using the available domestic currency resources to meet their external payments obligations promptly.

- (b) Lack of uniform and clear guidelines in the treatment of arrears and their elimination in consultation discussions, reports, and Decisions. I have requested Mr. McLenaghan to review the treatment of arrears in Consultations Decisions in the past two years.

It is my impression that in consultations conducted under Article VIII, or Article XIV, the Decisions occasionally used to refer to the existence of arrears and urge the members to eliminate them as soon as possible. In the current format of Decisions in Article IV consultations, however, as far as I know, there has been no instance of separate mention of arrears, and arrears have generally been approved as part of the exchange system described in the Staff Paper. As such, there has been a further slippage in the implementation of the 1970 Decision.

^{1/} For convenient reference the relevant portions are attached.

(c) Lack of clear guidelines with regard to the treatment of arrears, especially the recommended procedures for their elimination, in the context of use of Fund's resources. This has been a serious problem, although considerable progress has been made in recent months in clarifying the methodology involved.

3. I therefore feel that the need now is not for a Board paper reviewing the 1970 Decision, but a systematization of the procedures applied in regard to the implementation of that Decision. The increasing incidence of arrears in member countries makes this task particularly urgent.
4. At the staff level there is clear need for guidelines with regard to the identification, quantification, and elimination of arrears. Mr. McLenaghan's memorandum to you of July 27, is a useful contribution in this direction. The most important need is to spell out the methodology to be used in framing and implementing a program for the centralization and elimination of arrears. As an associated exercise, it would be useful to have a survey reviewing the experience since 1970 in regard to the Fund treatment of arrears, in the context of the Fund's approval jurisdiction as well as of use of Fund's resources.

A second urgent task at the staff level is to review the present practice in regard to arrears in BEAC and BCEAO countries. The Legal Department promised a paper on this subject over a year ago. In the meantime, as you know, the matter did come up at the Board in the form of a question by Mr. de Vries in the case of Togo, and I submitted a memorandum to the Acting Managing Director in consultation with Legal, explaining the present staff position why such arrears are not being regarded as exchange restrictions. I shall prepare a memorandum to go from you to Legal, presenting the reasons for a review of the present position.

5. As far as the Board is concerned, the treatment of arrears in the context of Article IV consultations procedures, and in the framework of the 1970 Decision, has to be addressed immediately in the forthcoming review of consultations procedures. The two points which need attention are (i) the treatment of arrears in the Decisions and in the Chairman's summary concluding Article IV consultations (as you know this question was raised by Mr. Dini during the discussion of the Madagascar consultation report) and (ii) the requirement in the 1970 Decision that Fund approval of arrears shall be on the basis of a "satisfactory program for their elimination."

cc: Mr. Finch
Mr. Palmer
Mr. Mookerjee
Mr. McLenaghan

ATTACHMENT

"The staff, in the consultation discussions, will have to establish whether payments arrears exist by ascertaining whether there has been a substantial delay beyond that usually required for ascertaining the bona fides of exchange applications or the time that can be regarded as normally required for the administrative processing of applications for exchange. If payments arrears exist and approval of the restriction giving rise to them is requested by the member, the member should be expected to submit a satisfactory program for their elimination. Approval if given should be only for a temporary period and generally with a fixed terminal date. Because of the difficulty in surveillance, approval should be wherever feasible in terms of the level of arrears outstanding. The program for the elimination of the payments arrears should provide for a maximum permissible delay to which a payment or transfer could be subjected, together with a phased reduction in the outstanding level.

Fund financial assistance to members having payments arrears should be granted on the basis of performance criteria or policies with respect to the treatment of arrears similar to the criteria or policies described in the preceding paragraph for the approval of the payments restrictions. In general, the understandings should provide for the elimination of the payments arrears within the period of the stand-by arrangement. Such understandings should be based on the concept of a given level of payments arrears and should be reflected in the performance criteria included in stand-by arrangements in the higher credit tranches. To support the policies designed to deal with arrears the letter of intent should include a statement that there would be no imposition of new restrictions or increase in the level of delayed payments. Where Fund financial assistance is being provided, but only through the first credit tranche, the adoption of a viable program directed toward the elimination of the payments arrears should be an important factor in considering whether the country was making reasonable efforts to redress its international financial situation."

INTERNATIONAL MONETARY FUND

March 12, 1986

Mr. Brachet
Mr. Quirk

The attached paper was given to me by Mr. Peter Heller of the Fiscal Affairs Department. I should be glad if you would look at it and let me have your views within the next week.



Attachment

W. A. Beveridge