FOR AGENDA



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April 25, 1984

To: Members of the Executive Board

From: The Secretary

Subject: The Role of the Fund in the Settlement of Disputes Between Members Relating to External Financial Obligations

The attached paper on the role of the Fund in the settlement of disputes between members relating to external financial obligations has been tentatively scheduled for Executive Board consideration on Wednesday, May 23, 1984.

If Executive Directors have technical or factual questions relating to this paper prior to the Board discussion, they should contact Mr. Kanesa-Thasan (ext. (5)7860) or Mr. Holder (ext. (5)7792).

Att: (1)

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INTERNATIONAL MONETARY FUND

# The Role of the Fund in the Settlement of Disputes Between Members Relating to External Financial Obligations

Prepared by the Legal and the Exchange and Trade Relations Departments

(In consultation with other Departments)

Approved by George P. Nicoletopoulos and C. David Finch

April 24, 1984

## I. Introduction

On a number of occasions, members have sought the Fund's assistance in order to settle their disputes relating to their financial obligations. These appeals to the Fund have included situations of both official and nonofficial obligations; in this paper, therefore, the phrase "external financial obligations" will include both categories of obligations.

In recent years, the severe balance of payments problems experienced by some members have exacerbated their difficulties in meeting external financial obligations. Accordingly, there have been demands on the Fund to increase its role in the settlement of overdue external financial obligations. Likewise, in some of these circumstances matters involving disputed obligations have arisen, requiring consideration of the way in which the Fund should respond.

The Fund has a direct interest in the settlement of overdue external financial obligations, in the sense that the Fund is clearly interested in the maintenance of an international monetary system in which external obligations are settled promptly and according to their terms. Thus, Article I embraces as general purposes of the Fund the promotion of international monetary cooperation, the provision of machinery for consultation and collaboration, the facilitation of the growth of international trade, and the fostering of a multilateral system of payments for current international transactions. These purposes of the Fund are to guide the Fund in its policies and decisions in the exercise of the more specific powers conferred in the Articles of Agreement.

Recently, Executive Directors have raised questions about the Fund's policies and practices in respect to its role in the settlement of overdue external financial obligations in general, and in disputes between members regarding such obligations, in particular.

During the Executive Board Seminar on External Debt Problems (EB Seminar 83/3, 12/12/83) the view was expressed that it would be timely to review and appraise the Fund's policies and practices in these respects, and the staff was asked to prepare a paper on the subject.

## II. Nature and Scope of the Issues

The Fund's involvement in the settlement of overdue external financial obligations might be conveniently treated within three contexts: (i) policies and practices of the Fund in exercising its jurisdiction under Article VIII and Article XIV; (ii) the extent to which the settlement of overdue external financial obligations is part of the Fund's conditionality on the use of the Fund's resources under Article V, Section 3; and (iii) the provision of good offices by the Fund, such as a financial and technical service under Article V, Section 2(b). For the first of these contexts, the role of the Fund relates mainly to deciding whether the situation involves jurisdiction or not and the application of the Fund's policies on approval of exchange restrictions. In the second context, the issue relates particularly to the ambit and application of conditionality. In both of these two contexts, the role of the Fund pertaining to overdue external financial obligations has evolved mainly pursuant to its policies and practices concerning payments arrears. At the same time, the role of the Fund regarding disputed obligations has continued to be relatively limited. Even so, upon occasion members have sought the assistance of the Fund's management and staff in order to ensure the settlement of a disputed financial claim. In such circumstances, the Fund's management and staff has sometimes been prepared to offer certain good offices in order to assist the interested members to resolve their differences.

Before examining the relevant policies and practices in detail, it might be useful to indicate the diversity of situations of overdue external financial obligations in general, in terms of both the variety of creditor-debtor relationships, on the one side, and the range of circumstances involving nonpayment of overdue financial obligations, on the other side.

First, in terms of debtor-creditor relationships, the original contracting parties may be either the member itself, on the one hand, or other governmental entities, independent state corporations, commercial entities, other institutions, corporations, other juridical entities, or individuals, on the other hand. In addition, a member, though not an original party, may have assumed rights and duties, such as by the operation of guarantees or by other means of assumption. Even in situations where the member is not the original creditor (or debtor) and has not assumed that status, it may choose, in line with the established international practice, to pursue the interests of its national creditors (or debtors) in international fora and by diplomatic means, or even by the espousal of a claim under international law.

Secondly, it can be noted that the nonpayment of external financial obligations may arise from different causes and circumstances. A partial categorization, based on cases which have been brought to the attention of the Fund, would include:

(i) The monetary authorities of a member may fail to provide the debtor with the foreign exchange required for settlement.

(ii) The debtor may lack sufficient domestic currency resources, because of budgetary reasons or otherwise, with which to purchase foreign exchange.

(iii) The debtor may choose not to perform the contractual obligations.

(iv) The member may decide, for reasons that may be termed "political", not to pay a debt or not to permit payment by debtors. At least two situations might be mentioned. First, the motivation may be found in political or national security interests (or, in the extreme, a state of war) between members. Second, it is possible that a change of state, a change of government, or the choice between two competing governments is involved, requiring on the side of the debtor a governmental decision on recognition before settlement can be carried out.

(v) Payment may be permitted in domestic currency, but transfers by the creditor may be restricted.

(vi) The value of the obligation, or the media of settlement, may be disputed. This may involve issues, for example, about the application of a value clause, the currency of settlement, or the applicable exchange rate.

(vii) The debtor might dispute the existence or validity of the obligation or some part of it. The potential range of disputes between the creditor and debtor is very broad, extending from the initial authority to contract the obligation, its validity, the existence and nature of particular contractual terms, technical legal points like satisfaction, counter-claims and waivers, questions relating to the effect of national law, and associated issues such as the duty to pay interest on unpaid obligations.

Based on the above, instances where the Fund's assistance has been sought by members in the settlement of overdue external financial obligations fall into two general categories: those where the parties accept the validity and amount of the obligation, and those where there is a dispute as to the validity of the obligation or some essential feature of it. In regard to the first category, the issues that have arisen for attention by the Fund have included the following:

(i) Whether there have in fact been failures to settle external financial obligations, including those under debt rescheduling agreements, and, if so, in what amounts.

(ii) The causes and circumstances of the failures to pay.

(iii) Whether the member, in the elimination of payments arrears, has discriminated among creditors.

(iv) Whether the member is making reasonable efforts to reach agreement with its creditors so as to meet its overdue as well as its current and future external debt service obligations, and in a manner which would ensure broad inter-creditor equity.

By and large, these issues have been dealt with in the context of the Fund's jurisdictional responsibility or the use of the Fund's resources. In contrast, in those situations where the validity of the external obligation or some feature of it has been in dispute, the Fund has sought to maintain a neutral position on the merits of the dispute, although the Managing Director has been ready to offer limited good offices functions if invited by both parties to the dispute.

## III. Fund Jurisdiction Under Articles VIII and XIV

A major purpose of the Fund is to assist in the establishment of a multilateral system of payments in respect of current international transactions and in the elimination of associated exchange restrictions. Under Article VIII, Section 2(a) of the Articles of Agreement, members have specifically undertaken not to impose restrictions on the making of payments and transfers for current international transactions, except for those approved by the Fund or otherwise authorized by the Articles. Many questions have arisen concerning the meaning and scope of Article VIII, Section 2(a), and the Fund has developed considerable jurisprudence and practice on it. (See, for example, "Legal Aspects of Article VIII and Article XIV", SM/59/73, (11/18/59).) There is no need, within the scope of this paper, to provide a full description of all the issues involved. Nonetheless, the following basic principles serve to delineate the scope of the Fund's jurisdiction, and set the limits of the Fund's jurisdictional function under Articles VIII and XIV with respect to overdue external financial obligations.

(i) "The guiding principle in ascertaining whether a measure is a restriction on payments and transfers for current international transactions under Article VIII, Section 2, is whether

it involves a direct governmental limitation on the availability or use of exchange as such." (Executive Board Decision No. 1034-(60/27), adopted June 1, 1960, Selected Decisions, Tenth Issue, pp. 241-42).

(ii) The Fund's jurisdiction is confined to "current international transactions", as distinct from capital payments and transfers. Article XXX(d) provides the following description of payments for current transactions:

"(d) Payments for current transactions means payments which are not for the purpose of transferring capital, and includes, without limitation:

(1) all payments due in connection with foreign trade, other current business, including services, and normal short-term banking and credit facilities;

(2) payments due as interest on loans and as net income from other investments;

(3) payments of moderate amount for amortization of loans or for depreciation of direct investments; and

(4) moderate remittances for family living expenses."

(iii) In assessing an exchange measure as "restrictive", both the form and effect of the measure is examined, in close collaboration between the Fund and the member.

(iv) "Undue delay in making foreign exchange available for payments or permitting its transfer for current international transactions is a restriction under Article VIII, Section 2(a) and under Article XIV, Section 2 of the Articles of Agreement", (SM/70/139, (7/6/70), pp. 1-2). Based on this proposition, in 1970 the Fund adopted the following policy concerning payments arrears:

"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." (Executive Board Decision No. 3153-(70/95), adopted October 26, 1970, Selected Decisions, Tenth Issue, p. 244.)

Article VIII, Section 2(a) refers to "approval" by the Fund. Consequently, the Fund has established policies on approval of exchange restrictions. Some of these policies are:

(i) To be approved, the exchange restrictions need to be introduced or maintained for balance of payments reasons, and the Fund must be satisfied that the measures are necessary and that their use will be temporary while the member is seeking to eliminate the need for them. (Executive Board Decision No. 1034-(60/27), adopted June 1, 1960, Selected Decisions, Tenth Issue, p. 241).

(ii) In addition, in practice the Fund does not approve exchange restrictions when they are discriminatory in form and effect as between members of the Fund. (See Executive Board Decision No. 955-(59/45), adopted October 23, 1959, Selected Decisions, p. 240, and Executive Board Decision No. 6790-(81/43), adopted March 20, 1981, Selected Decisions, p. 257).

(iii) In the case of payments arrears, approval of the payments restrictions giving rise to them requires the submission of a satisfactory program for their elimination. (Executive Board Decision No. 3153-(70/95), adopted October 26, 1970, Selected Decisions, Tenth Issue, p. 243.)

(iv) A limiting situation with regard to the exercise of the Fund's jurisdiction relates to the Executive Board's decision concerning payments restrictions for security reasons (Executive Board Decision No. 144-(52/51) adopted August 14, 1952, Selected Decisions, p. 235.) It will be recalled that, pursuant to that decision, members may notify the Fund that particular exchange restrictions are imposed for reasons of national or international security. Thereupon, unless the Fund decides otherwise within 30 days, the restrictions are taken to be approved by the Fund.

Pursuant to these policies and practices concerning jurisdiction under Articles VIII and XIV, the Fund is intimately involved, on a continuous basis, with questions relating to the settlement of overdue external financial obligations. In fact, this arises as an integral part of the Fund's normal process of consultation and cooperation with members, and the periodic consultation discussions by the Executive Board. To this end, the Fund's management and staff, as part of the regular contact with members, collect information about the exchange system, including payments arrears, analyze situations, pursue a dialogue with national authorities regarding policies to strengthen the balance of payments positions and to eliminate overdue external financial obligations, appraise the need for approval of exchange measures under Article VIII, and make reports to the Executive Board. In collecting and appraising this information, the cooperation of the national authorities is expected, in accordance with the obligation of members under Article VIII, Section 5, to furnish information on the exchange system and on other information deemed necessary by the Fund for its activities, as well as under other Articles and decisions of the Fund.

In this process of consultation, and in the context of the exercise of the Fund's jurisdiction, national authorities, as well as particular creditors, frequently inform the Fund about unsettled external financial obligations. Often, nongovernmental creditors have contacted the Fund's management and staff regarding unpaid financial claims and requesting Fund assistance; in these types of cases the petitioner is normally informed that the Fund cannot be of assistance. 1/ When, however, the member is the creditor, or when a member decides to espouse the claims of a nongovernmental creditor, the matter might be pursued either informally with the Fund's management and staff or by raising the matter for consideration by the Executive Board. It is also open to a member to lodge a complaint to the Executive Board under Rules H-2 and H-3 if another member is in breach of its obligations concerning exchange controls. 2/

Despite this general involvement of the Fund in situations involving overdue external obligations, in the context of the exercise of its jurisdiction under Articles VIII and XIV, certain additional qualifications need to be added. As noted in Section II above, a debtor's nonpayment of an external obligation may be due to a wide variety of causes, and the Fund is clearly limited in its capacity to examine each factual situation in order to determine the cause of nonpayment of a particular external obligation. The Fund does, however, examine the circumstances of an exchange measure, including its implementation, so that it can be decided whether or not an exchange restriction exists. In doing so, however, two additional inhibitions qualify the exercise of the Fund's jurisdiction over exchange restrictions.

First, the Fund has found it necessary, in the exercise of its jurisdiction, to distinguish between nonpayment of obligations because of exchange restrictions, on the one side, and nonpayment of obligations that are to be treated as defaults, on the other side. Thus a member's refusal to make payments according to its own contractual commitments that it has undertaken in connection with current international transactions would be classified as a default and not a restriction, except

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1/ In the context of judicial and administrative proceedings involving the application of Article VIII, Section 2(b) of the Articles of Agreement, the Executive Board has decided that the Fund "is prepared to advise whether particular exchange control regulations are maintained or imposed consistently with the Fund Agreement". (Executive Board Decision No. 446-4, adopted June 10, 1949, Selected Decisions, Tenth Issue, p. 233.)

2/ "H-2. If a member complains to the Executive Board that another member is not complying with its obligations concerning exchange controls, discriminatory currency arrangements, or multiple currency practices, the complaint shall give all facts pertinent to an examination.

H-3. Upon receipt of a complaint from a member, the Executive Board shall make arrangements promptly for consultation with the members directly involved."

insofar as the refusal is made in the context of a restrictive system applicable to all such payments, when the nonpayment of a foreign obligation by the government or one of its agencies would constitute an exchange measure subject to the Fund's jurisdiction. In the 1980 Executive Board paper on payments arrears, the category of default was extended to governmental obligations as follows:

> "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." (EBS/80/90, (8/27/80), p.9.)

A second qualification to the exercise of the Fund's jurisdiction must be added: according to current Fund practice, in situations where a debtor disputes the validity of an external financial obligation, or some feature of it, the Fund is not in a position to determine whether there is or is not a particular payments arrear and the Fund ceases to have a role under its Article VIII approval jurisdiction. In such situations, furthermore, the Fund has taken the view that a member's representation that the debtor disputes the validity of an obligation should be taken as being made bona fide and accepted on that basis. Nonetheless, the Fund retains the right to conclude that the debtor's contention is clearly without merit and that, therefore, the dispute should not have the effect of removing the related nonpayment from the Fund's jurisdiction.

In summary, in terms of the jurisdiction of the Fund under Article VIII, it is apparent that the Fund is called upon to examine situations of overdue external financial obligations. This involves the Fund in a continuing dialogue with members. In applying Fund policy on payments arrears, the Fund must determine, as for other exchange measures, whether or not an exchange restriction subject to Fund jurisdiction is involved, in which case the Fund's policies for approval come into play. As already noted, in many situations concerning external financial obligations the matter will be subject to Fund jurisdiction under Article VIII,

Section 2(a), in view of the broad definition of payments and transfers for current international transactions provided in Article XXX. In some situations, however, Fund jurisdiction under Article VIII, Section 2(a), will not be involved, such as when the payments do not relate to current international transactions, when the nonpayment of obligations of the member itself are treated by the Fund as defaults, and when the validity of the obligation is in dispute. In these situations, however, it may be open to the Fund to assume a role in connection with the use of its resources or in the performance of good offices.

## IV. Use of the Fund's Resources

Most recent requests for Fund assistance in the settlement of overdue external financial obligations have arisen in the context of the use of the Fund's resources. Under the policies and practices of conditionality, it is well established that conditionality in regard to the use of the Fund's resources is not confined to matters within Fund jurisdiction under Articles VIII and XIV. The Fund has express authority under Article V, Section 3 (a), to adopt policies on the use of its general resources in order to assist members to solve their balance of payments problems and to safeguard the temporary use of its resources. In this context, the Fund has established policies concerning payments arrears which require not only the avoidance of new payments arrears, but also calls for steps to reduce and eventually to eliminate the outstanding stock of arrears. (Executive Board Decision No. 3153-(70/95), adopted June 26, 1970, Selected Decisions, p. 243.) Moreover, payments arrears in this context are at times treated by the Fund as comprehending all overdue external financial obligations, thus including some categories of payments arrears that are not the result of exchange restrictions within the scope of Article VIII, Section 2, such as payments arrears in respect of capital transactions not within the ambit of Article XXX(d), as well as certain nonpayments by the member in the nature of defaults. (See "Review of Fund Policies and Procedures on Payments Arrears", EBS/80/190 (8/27/80), p. 14.)

The Fund also has come to expect that, at the time of approval of arrangements, there should be a reasonable assurance that the amount of external financing necessary to make the program sustainable would be available; in other words, that there is no "external financing gap." This requirement is intended to ensure, as far as practicable, that the amount of external financing available over the program period will be adequate to support the member's balance of payments adjustment program, so that the targeted reduction in outstanding payments arrears as well as the avoidance of new arrears can be realized. In practice, to satisfy this requirement the member has, in many cases, had to enter into agreements with its creditors to consolidate its existing payments arrears as well as to reschedule its maturing debt service obligations before the Fund's financing is made available.

In the context of the use of the Fund's resources, members have sought the assistance of the Fund in several respects, including:

(a) The collection of comprehensive and authoritative information on the amount and type of outstanding payments arrears, as well as on maturing debt service obligations;

(b) The monitoring of information on payments arrears to ensure that they are being reduced by the intended amounts as well as in an orderly and nondiscriminatory manner; and

(c) Where rescheduling of existing arrears and the refinancing of maturing debt have been associated with a Fund program, to oversee that the rescheduling agreements are observed, and that the principle of inter-creditor equity is followed.

The requests for assistance flow from both creditor and debtor members, reflecting their separate interests and concerns. In many instances, the Fund is already involved in the matter, because of its connection with the member's adjustment program, its implementation, and its monitoring.

The importance of collecting better information on payments arrears and debt, and the need to strengthen monitoring procedures, are generally agreed. The tasks, however, have proved difficult; while many debtor members lack proper recording practices, the data sources in the creditor countries have also proved deficient. In many cases, therefore, the Fund staff has had to make substantial efforts to assist the member in collecting reliable data on debt and payments arrears, both by regular missions and technical assistance programs. In addition, a number of members have decided to use the services of private consultants. Despite these efforts, problems often persist in many countries in compiling complete data on debt and payments arrears, especially those obligations owed to private creditors, and in setting up adequate machinery for their monitoring and liquidation.

A Fund-supported program normally calls for the avoidance and reduction of payments arrears in an orderly and nondiscriminatory manner, although not necessarily as a performance criterion of the arrangement. The determination as to whether or not that standard has been met is a difficult one to make. As noted in EBS/82/57 1/ the desirable pattern for settlement of arrears is dependent on a number of criteria. These could include the "first in first out" principle aimed at maximizing equity, "last in first out" principle aimed at re-establishing normal credit relationships as quickly as possible, and the principle of providing priority for payments for essential imports. Each of these

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1/ "External Payments Arrears of Fund Members, 1980-81" (EBS/82/57, (3/31/82), p. 11).

principles can be applied without necessarily resulting in discrimination between members; therefore nondiscrimination need not mean a strictly pro-rata reduction of arrears among creditors. The existence of discriminatory treatment is especially difficult to determine if there has been some payment to each creditor. Therefore, a close examination of the data is required in each case. However, as noted earlier, full information on arrears in the necessary level of detail, by creditors and types of transactions, is seldom available. In such a situation, the staff has had to make the best judgment possible, based on the available information.

In multilateral debt rescheduling operations, a major objective has been to assure equity in burden-sharing among different groups of creditors and between individual creditors. At the same time, it has been difficult to achieve, as a result of differing treatment by various creditors of interest and amortization payments, short-term debt, and the provision of new finance. Some creditor groups, including the Paris Club, explicitly require that the debtor country seek to obtain from nonparticipating creditors debt relief on terms comparable to those granted by them. Direct enforcement of this requirement is a matter for the Paris Club and other creditors and not the Fund. While comparable treatment of creditors is undoubtedly worthy of support, including it as a general performance criterion would not be practical, especially because of difficulties in monitoring.

Executive Directors have asked recently about the implications of Paris Club reschedulings to a member's performance under Fund arrangements--first, when delays have been experienced in concluding bilateral agreements with individual participants in Paris Club reschedulings, and, secondly, when a member fails to accord comparable treatment to other members who are not participants in Paris Club reschedulings. With regard to the first question, 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 programs, to treat the associated payments arrears as having been eliminated. 1/ The Paris Club also requires ratifying bilateral agreements with individual creditors which are expected to be entered without undue delay. In the event of such delays, which often arise as a result of problems in the collection and verification of relevant data, in the past the Fund has sought to deal with them, for purposes of its arrangements, on a case-by-case basis. Since the Paris Club now stipulates a final date for concluding the

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1/ 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.

bilateral agreements, 1/ 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 the debtor's best efforts.

In regard to the second question, the most direct way of ensuring comparable treatment to official creditors would be for all of them to be represented in the Paris Club. If that were not possible for any reason, the creditor member that is outside the Paris Club could seek a bilateral agreement on the same terms, and within the same time limit, as specified in the multilateral Paris Club Agreed Minutes. 2/ In that event, the Fund would normally conclude that the failure to conclude such a bilateral agreement breached the performance criterion on payments arrears.

The Fund has also to react to some circumstances of multilateral debt rescheduling in which the debtor member and the creditors have been unable to reach agreement in principle. When the financing involved has been essential to the financial integrity of the member's program, then the Fund has at times delayed approval of the arrangement (or, if later in time, the relevant performance criteria have been breached). In some cases, the Fund's management and staff have been prepared to promote the conclusion of the necessary agreements, and to take initiatives in this regard. Important objectives have been to ensure an adequate level of new financing as well as its equitable sharing among creditors. This was particularly true where the amounts of debt to be rescheduled as well as of new financing commitments

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1/ The maximum period for concluding bilateral agreements is currently nine months from the date of the multilateral agreement. Failure to complete bilateral agreements by that date would normally prevent purchase of the last installment under annual Fund arrangements. In some recent cases, and as part of the Paris Club Agreed Minute, the debtor country has agreed to establish an account with a central bank abroad into which monthly deposits are made. The total amount to be deposited approximates the amounts estimated to be payable to all participating creditor countries during the year. The debtor country would draw on the account as bilateral implementing agreements are signed and specific payments under these agreements become due.

2/ Paris Club Agreed Minutes set forth understandings covering the amount and maturity structure of debt rescheduling, and leave interest rates to be agreed bilaterally between the debtor and each creditor. Information on the terms of the agreed minutes is regularly available to the Executive Board after each such meeting, but information on the terms of bilateral agreements is regarded as confidential. Executive Directors could be regularly informed in advance of all forthcoming meetings of the Paris Club.

were very large. Another important consideration in these cases has been the systemic risks involved in the event timely agreement is not reached on an adequate financing package.

Apart from such cases, there have been instances where the Fund's assistance has been sought by the debtor country, not only in the collection of the data needed for debt rescheduling, but also in the negotiation of the terms of rescheduling, especially with commercial banks. Often these requests have been prompted by the extremely limited amount of exchange available to the debtor to service its external debt and by delays in obtaining the concurrence of all creditor banks to an agreement that had been proposed by a bank steering committee. In such situations the Fund staff has been prepared to participate in the discussions between debtors and creditors, principally to explain the adjustment program which the debtor member intends to implement with the support of the Fund and the medium-term economic framework in which the program had been formulated. In general, the management and staff have maintained a neutral role in the debt renegotiation process, as was indicated in the staff paper on "Fund Policies and External Debt Servicing Probems" (SM/83/45, 3/8/83), and the Managing Director's summary of the Executive Board discussions (EBM/83/58, (4/6/83)). On some occasions, the management and staff had also intervened to recommend to the parties a reasonable basis for an agreement. In so doing, the staff has generally taken into account the balance of payments outlook and financing needs of the debtor country, requirements of broad intercreditor equity, and information on rescheduling agreements concluded by other debtors in comparable circumstances. On these limited occasions, the staff's recommendations have focused on the amount and maturity structure of the debt relief and new financing, and not the commercial aspects of creditor-debtor relationships like interest charges, fees, etc.

An important innovation in this area has been the appointment of an external financing coordinator for one member country. In that case, the aid coordinator has played a key role not only in the collection of comprehensive data on external debt and arrears, but also in devising ways of ensuring adequate terms of the financing of the Fund program, including comprehensive debt rescheduling agreements with major creditor groups.

It has sometimes been suggested that the Fund, because of the linkage between its financing arrangements and the debt rescheduling agreements, should assume some responsibility for ensuring that the rescheduling agreement is implemented by the debtor member--not only during the period for which the member has an arrangement with the Fund, but also thereafter. As noted earlier, if a member fails to maintain its repayment obligations under debt rescheduling agreements, this would in many cases breach a performance criterion of the Fund's arrangement. This particular influence of the Fund would cease, however, when the member no longer has a financing arrangement with the Fund.

In summary, conditionality provisions of the Fund's arrangements have served directly to promote the settlement of overdue external financial obligations. The Fund has included performance criteria in its arrangements which go beyond matters that fall within the Fund's jurisdiction under Articles VIII and XIV. Overall, it could be concluded that current practices in regard to the settlement of overdue external obligations of members, in the context of the use of the Fund's resources, are generally appropriate.

## V. Provision of Good Offices by the Fund

In all cases of nonpayment of overdue external financial obligations it is open to a member, either as creditor or in the interests of the actual creditor, to bring the matter to the attention of the Fund as part of its efforts to secure payment from the debtor. This may occur, as seen above, in the course of the Fund's exercise of jurisdiction or in the context of use of the Fund's resources. It may arise, however, apart from these two contexts. In all situations of nonpayment of external financial obligations, including those involving disputes as to the validity of the obligation, the Fund may, with the agreement of the members involved, perform a complementary role, namely, the provision of good offices to facilitate their efforts to find solutions.

Resort to the good offices of a third party is well founded in international practice. In the course of negotiating their differences, and without submission to the judicial process, states, as part of the process of negotiation, may choose to invite the intervention of a third party. The point of this involvement is simple: when direct negotiation has run into difficulties, a third party may be able to assist. The contribution of this third party may be limited to restarting the negotiations. At times, the third party might be expected to go further, and to clarify facts and express a view on appropriate terms of settlement, and even to mediate actively between the parties.

Depending upon the degree of involvement, the third party's role may involve one or more of the following functions:

(i) In the conduct of good offices, a third party tenders its services in order to bring disputing parties together. Thereupon, the nature of the problem may be reviewed, and general terms for the settlement of the dispute may be suggested--without active participation of the third party in the negotiation, and without exhaustive analysis of the issues.

(ii) Mediation provides the third party a more active role; the mediating party participates in the efforts to find an agreed solution through negotiation. Being nonjudicial, the solution has no binding effect on the parties.

(iii) Conciliation, in its technical meaning, denotes the reference of a dispute to a committee or commission, to make proposals to the parties for their consideration.

(iv) A further possibility is inquiry, whereby, without making specific recommendations, the assignment of the third party is to establish the facts, thereby encouraging a negotiated settlement.

In recent years, good offices have been increasingly performed within the ambit of the United Nations bodies and other international organizations. In the United Nations, for instance, the Secretary-General regularly performs a wide range of good offices functions. 1/ The specialized agencies, too, through their executive heads and secretariats, likewise perform good offices functions consistent with the purposes of the organizations.

Under the Articles of Agreement, it is open to the Fund to perform good offices in financial and economic matters if this would be to the benefit of its members. From the early years of the Fund's existence it has been recognized that the Fund has had the power to perform technical and financial services for members. On this basis, beginning in 1952 the Fund decided to assist members by arranging gold transactions. Other technical and financial services included the provision of technical assistance to members, the administration of the Subsidy Account, the involvement of the Fund in the Trust Account, and the performance of services by the Managing Director in connection with the arrangement on sterling balances.

Authority to perform these services was derived mainly from the general purposes of the Fund and, in particular, Article I (1):

"The purposes of the International Monetary Fund are:

(i) To promote international monetary cooperation through a permanent institution which provides the machinery for consultation, and collaboration on international monetary problems ..."

The Second Amendment made explicit this function of the Fund. By Article V, Section 2(b),

"If requested, the Fund may decide to perform financial and technical services, including the administration of resources contributed by members, that are consistent with the purposes of the Fund. Operations involved in the performance of such

1/ See V. Pechota, The Quiet Approach: A Study of the Good Offices by the United Nations' Secretary-General in the Cause of Peace (UNITAR, 1972).

financial services shall not be on the account of the Fund. Services under this subsection shall not impose any obligation on a member without its consent."

In performing such services, and based on the terms of Article V, Section 2(b), the Fund must operate within the following limitations:

(i) The services must be consistent with the purposes of the Fund.

(ii) The services to be performed must be in accordance with the established policies of the Fund.

(iii) Services must be for the benefit of members.

(iv) Services may not subject the Fund or its assets to any obligation or liability, although the Fund may decide to absorb the administrative cost of the services it performs.

(v) Services may not impose obligations on members without their consent.

In the circumstances of the settlement of overdue external financial obligations, the provision of good offices to members would be authorized by Article I and Article V, Section 2(b). Specifically, such services would be consistent with the purposes of the Fund, in that the Fund would be endeavoring to promote international monetary cooperation, and the activity would be quite consistent with the other limits on the performance of Fund services. Whether the Fund will perform services, the scope of the particular services, and the manner in which they should be conducted, are matters for decision by the Executive Board, pursuant to its judgment as to what, in light of the purposes of the Fund, would be the appropriate involvement of the Fund in the settlement of debt and financial disputes.

In terms of approach, the Executive Board could examine the question of the performance of good offices each time that it arose, thereby endorsing the particular services to be rendered. Alternatively, the Executive Board might wish to establish a more general policy for the purposes of assisting and guiding management and staff. The authority entailed could be narrow or extensive. It will be recalled, also, that in other areas of the Fund's activities, such as in the exercise of its surveillance functions under Article IV, the Executive Board has empowered the Managing Director to take certain initiatives, to consult with members, and to make appropriate determinations.

As a matter of practice, the Fund has been performing good offices functions in several different ways, extending beyond its consultative and coordinating roles comprehended within the contexts of Fund jurisdiction and the use of the Fund's resources, particularly in two types of

situations. The first type of situation has arisen in fairly narrow circumstances. Upon occasion, the Managing Director has been asked by members with a contentious financial dispute either to serve as an arbitrator or conciliator, or to nominate a suitable candidate for that purpose. 1/ In these cases, the response of the Managing Director has been to decline to act as an arbitrator, but to assist in the search for a mutually acceptable expert. There is also one instance in which the Managing Director, with the approval of the Executive Board, accepted that he would nominate an arbitrator pursuant to a clause in a monetary treaty providing for arbitration between the parties in the event of a dispute. 2/ The second type of situation has arisen when members have disputed a financial claim or some essential feature of it. On a number of recent occasions, when members have disputed the validity of particular obligations, the management has assisted members by providing premises and limited support services, and has offered to serve as chairman.

In summary, in recent years the Fund has had to react to a variety of situations involving disputes between members relating to external financial obligations. In some of these instances, the Managing Director has informed the Executive Board of management's willingness to assist

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1/ The following examples are illustrative:

In 1953 the Executive Directors for Japan and The Netherlands requested the Managing Director for advice, or alternatively to designate an outside person to act as advisor, in a dispute arising out of payments on a bond issued by the Government of Japan. The Managing Director was prepared to suggest an advisor.

In 1954, the Bank Melli Iran requested the Managing Director to appoint an arbitrator pursuant to a provision in an oil agreement between the Government of Iran and an oil corporation, on the one hand, and the International Oil Consortium, on the other hand. The dispute dealt with applicable exchange rates under the oil agreement. The Executive Board authorized the Managing Director to make the appointment under the agreement (EBD/54/116, (10/11/54), and Supplement 1).

In 1969 the Governments of Yugoslavia and India requested the Managing Director's assistance in interpreting a valuation clause in certain trade, payments, and credit agreements between them. The Managing Director stated that he would consider naming arbitrators or conciliators only if the parties were prepared to make a joint approach to him and to agree on the procedures. Upon being informed, Executive Directors did not object (EBM/70/21, (3/11/70)). The staff then assisted in the search for a suitable arbitrator.

2/ In 1974 the Managing Director was contacted by the authorities of South Africa, Lesotho, and Swaziland with reference to a draft monetary treaty among the three countries that would involve an arbitration clause in the case of disputes over interpretation. Specifically, in some situations the Managing Director would be requested to appoint an arbitrator. The Managing Director informed the Executive Board of his willingness to do so; the Board did not object (EBM/74/14, (11/30/74)).

by suggesting a suitable arbitrator upon request of the parties, and, in some cases, by facilitating contact and exchange between the parties. In so doing, the Fund has acted only with the concurrence of the members directly involved. In addition, it has been the understanding that the Fund's management and staff would be involved only in a technical capacity, with the Fund adopting no view on the merits of the dispute. In taking this low-key approach, it has been clearly recognized that the contribution of the Fund in this area can and must be limited in nature and scope.

It can be seen that the Fund's performance of good offices in order to assist members resolve disputes concerning external financial obligations has not been extensive. At the same time, the Fund is clearly empowered to offer such good offices to its members, and the services have continued to be provided on an ad hoc basis. In general, the management and staff have proceeded cautiously, in order not to venture beyond their resources and expertise, and to avoid involvement in differences or disputes that may be political in nature.

In light of this experience, it might be concluded that the present ad hoc approach to the Fund's performance of good offices is appropriate, and therefore at this time an Executive Board policy formulating the circumstances and terms of performance by the Fund of its good offices functions relating to disputes between members in respect of financial obligations is not necessary. Within the ambit of existing practices, and without the spelling out of an overt policy, a more active involvement by the Fund might be envisaged, for example, in the determination of facts, the provision of technical analysis, and some move toward active conciliation and mediation. Further, in the light of the past experience, the staff would recommend that good offices be available to members in the settlement of their disputes relating to external financial obligations, if so requested by all parties to the dispute, provided that the provision of such services would be within its authority and within the constraints of its available resources.

## VI. Conclusion

This paper has set out the Fund's policies and practices in respect of its role in the settlement of disputes between members relating to external financial obligations. In this survey, a broad view has been taken of the range of differences between members concerning their external overdue financial obligations; thus, no particular meaning has been attributed to the concept of "dispute", and the opportunity has been taken to spell out developments in the range of situations encountered in practice.

For the purpose of the review, the activities of the Fund have been divided into three general categories: the exercise of Fund jurisdiction under Articles VIII and XIV; the application of conditionality in the

context of the use of the Fund's resources; and the provision of good offices by the Fund. For each of these contexts, and based on the general purposes of Article I and particular powers contained in the Articles, the Fund has continued to deal with problems concerning overdue external financial obligations. It has been seen that for each of these three contexts the Fund has considerable authority to exercise a role, and has in fact assumed a role.

For the exercise of jurisdiction under Articles VIII and XIV, the Fund has acted pursuant to its general policies and decisions on jurisdiction. This has involved the Fund in the examination of relevant exchange measures in order to determine the existence of exchange restrictions subject to approval and, thereupon, in the application of its policies on approval. In this way, the Fund has exercised its authority in situations involving disputes between members, including, amongst other situations, those involving discriminatory exchange restrictions.

Turning to the use of the Fund's resources, it has been seen that the Fund's conditionality impacts substantially on situations concerning the settlement of overdue external financial obligations, and the Fund has had to respond to a diversity of circumstances. Overall, it could be concluded that current practices and policies in these areas are generally appropriate. In each of the situations discussed two features have been dominant; first, the frequent absence of complete, data, and, second, the need for the Fund's management to exercise a substantial measure of discretion in particular circumstances. Finally, it may be appropriate to inquire whether, in some of the more complex situations, especially when there is a lack of agreement between a debtor member and its creditors, the Fund management should assume a more active role.

The third context, which need not necessarily be exclusive of the first two contexts, is that of the performance by the Fund of good offices functions. In this respect, the Fund, as the international agency with primary responsibilities concerning the international monetary system, might be expected to provide such services as within its expertise. As observed, the Articles confer substantial authority on the Fund to perform financial and technical services. With regard to the performance of good offices, the Fund has in fact assumed a role in specific financial disputes between members, including situations in which there was a dispute between the parties as to the existence or validity of an obligation. Until now, these good offices services have been performed by the Fund on an ad hoc basis, at the request of both parties, and have been limited in scope. Based on this experience, the Fund stands in a good position, and should stand ready, to offer its good offices to members, within the limits of its authority, expertise, and resources.