

INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 84/166

10:00 a.m., November 19, 1984

J. de Larosière, Chairman  
R. D. Erb, Deputy Managing Director

Executive Directors

Alternate Executive Directors

M. Finaish

w. B. Tshishimbi  
M. K. Bush  
M. Lundsager, Temporary  
H. C. Schneider  
X. Blandin  
T. Alhaimus  
T. Yamashita  
B. Goos

J. E. Ismael

L. Leonard  
C. Robalino  
A. S. Jayawardena  
A. Abdallah

F. L. Nebbia  
Y. A. Nimatallah  
P. Pérez  
J. J. Polak

J. E. Suraisry

G. Salehkhoul  
J. Tvedt

A. V. Romuáldez  
O. Kabbaj

S. Zecchini  
Zhang Z.

T. A. Clark  
N. Coumbis  
Wang E.

L. Van Houtven, Secretary  
R. S. Franklin, Assistant

1. São Tomé and Príncipe - 1984 Article IV Consultation . . . Page 3
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Also Present

African Department: F. d'A. Collings, M. Dairi, J. R. Hill. European Department: R. P. Hicks. Exchange and Trade Relations Department: M. Guitián, Deputy Director; E. H. Brau. External Relations Department: H. O. Hartmann. Legal Department: G. P. Nicoletopoulos, Director; Ph. Lachman, A. O. Liuksila, J. K. Oh, S. A. Silard. Middle Eastern Department: S. Kawar. Secretary's Department: J. W. Lang, Jr., Deputy Secretary. Treasurer's Department: W. O. Habermeier, Counsellor and Treasurer; D. Williams, Deputy Treasurer; D. Berthet, W. L. Coats, Jr., S. I. Fawzi, D. Gupta, W. E. Hermann, A. W. Lake, T. B. C. Leddy, P. van den Boogaerde, G. Wittich. Western Hemisphere Department: M. Caiola. Internal Auditor: C. P. McCoy. Personal Assistant to the Managing Director: S. P. Collins. Advisors to Executive Directors: A. A. Agah, E. A. Ajayi, H. A. Arias, G. Castellanos, D. Hammann, G. E. L. Nguyen, J.-C. Obame, P. Péterfalvy, T. Sirivedhin, D. C. Templeman, N. Toé, A. Vasudevan. Assistants to Executive Directors: E. M. Ainley, I. Angeloni, J. Bulloch, M. Camara, M. B. Chatah, Chen J., L. E. J. M. Coene, J. de la Herrán, V. Govindarajan, N. Haque, G. D. Hodgson, A. K. Juusela, H. Kobayashi, S. Kolb, R. Msadek, K. Murakami, E. Olsen, T. Ramtoolah, M. Rasyid, D. J. Robinson, J. E. Rodríguez, C. A. Salinas, A. A. Scholten, S. Sornyanontr, L. Tornetta, A. J. Tregilgas, A. H. van Ee, E. L. Walker, A. Yasserí.

1. SAO TOME AND PRINCIPE - 1984 ARTICLE IV CONSULTATION

The Executive Directors considered the staff report for the 1984 Article IV consultation with São Tomé and Príncipe (SM/84/225, 10/12/84; and Cor. 1, 10/22/84). They also had before them a report on recent economic developments in São Tomé and Príncipe (SM/84/243, 11/2/84).

The staff representative from the African Department observed that the staff had inadvertently omitted from its appraisal a recommended consultation cycle for São Tomé and Príncipe. In view of the authorities' request for closer and more frequent contacts with the Fund, the staff was recommending that consultations be conducted on a 12-month cycle.

Mr. Tshishimbi remarked that, as a small, tropical island economy, São Tomé and Príncipe faced complex structural problems in addition to those related to its relative isolation. The major export crop, cocoa, was nearly the only source of foreign exchange; and persistent economic and financial difficulties of recent years had left the economy in 1984 facing large fiscal and external imbalances and intensified inflationary pressures. In 1983, real GDP was estimated to have fallen by more than 10 percent, mainly because of problems in the dominant agricultural sector. Production of cocoa and other cash crops had been hampered by a variety of factors, including an insufficient labor force, managerial difficulties, and low productivity. Insufficient rainfall had also contributed to the stagnation in output of the main food crops. On the other hand, the acquisition and operation of an additional modern fishing vessel had boosted fish supplies for domestic consumption and for export.

The performance of the manufacturing sector had been mixed in 1983, Mr. Tshishimbi continued. While the output of baked goods, ceramics, and lumber products had risen significantly, the production of beer had declined because of a shortage of inputs and the temporary closing of a section of the brewery for extension work. Concerned with the continued deterioration in the agricultural sector, the authorities were undertaking to stimulate output. In particular, a program under preparation with the assistance of the World Bank was aimed at rehabilitation of the cocoa sector and called for a restoration of other ailing agricultural enterprises over time. Moreover, fishing agreements had been concluded with several members of the European Communities and, with assistance from the World Bank, the authorities were exploring the possibility of increasing small investment projects in the fisheries sector. More generally, they were attempting to diversify the productive base under a medium-term development plan through expansion of the production of other crops such as copra and palm kernels and a more active exploitation of the fish resources.

Since its accession to independence, São Tomé and Príncipe had been burdened by the lack of a well-trained national civil service and experienced managers, Mr. Tshishimbi remarked. As in most small island economies, those shortcomings had affected the performance of the economy, particularly on the fiscal side. The evolution of the overall fiscal

deficit during the past few years reflected an increase in investment expenditures--related to projects for which external financing had been available--and a shrinking of the revenue base. In 1983, despite the significant deceleration in the rate of execution of some of those development projects, overall public expenditures had remained high, owing mainly to an increase in subsidies to the ailing local sector. In view of the limited prospects for rapid growth of revenue in the near future, the authorities had given priority to the control of expenditure; they had recently decided to budget only investment expenditures for which financing had been secured and to review all investment projects not completed before the end of the fiscal year in order to eliminate, or at least postpone, nonpriority projects.

The evolution of the monetary aggregates in São Tomé and Príncipe had paralleled the financing needs of the public sector, Mr. Tshishimbi commented. The increase in the Government's recourse to bank credit in 1983 had been a direct consequence of the weak performance of some public enterprises, especially in the agricultural sector. The authorities were aware that undue reliance on bank credit could have adverse consequences for prices and real incomes. Interest rates, they felt, played only a minor role in the economy.

In the external sector, the current account deficit was estimated to have decreased sharply in 1983, owing to a contraction of imports and an increase in official transfers, Mr. Tshishimbi said. The shrinking of imports should be seen in relation to the completion of some important development projects, and the rise in transfers reflected the increased inflows of emergency food aid in response to shortages caused by the drought. Export performance in 1983 had remained subdued, as the favorable effect of the bilaterally guaranteed export price of cocoa had been more than offset by the decrease in the volume exported. In general, the improvement in the current account had failed to make up for the deterioration in the capital account, reflecting the impact of the completion of the development projects to which he had earlier alluded, as well as to increased amortization payments. As a result, the overall balance of payments deficit had increased somewhat. The authorities were concerned about the unfavorable developments described in the staff report and were looking forward to comments by Executive Directors.

Ms. Lundsager supported the staff's recommendation that São Tomé and Príncipe join those countries on the standard 12-month cycle for Article IV consultations. The previous consultation had been held in October 1982; during the intervening two years, there had apparently been little progress in improving the statistical base. Perhaps more frequent consultations with the Fund would provide an incentive for such improvement. She could also endorse the staff's suggestion that the authorities take advantage of the technical assistance available from various institutions.

The staff report showed no strengthening of economic or financial conditions in São Tomé and Príncipe during the past two years, Ms. Lundsager continued. The economy had continued to contract at a high rate, while

inflation had been increasing. The budget deficit had grown to equal 75 percent of GDP, and the current account deficit was expected to exceed 50 percent of GDP in 1984. Clearly, the authorities were facing an unsustainable situation, which they were attempting to contain at present through the use of restrictive exchange and trade regimes. For the immediate future, policies in São Tomé and Príncipe should be aimed at addressing the two sectors at the center of the country's current economic difficulties, namely, the public enterprise sector and the cocoa industry.

Export diversification was a goal often endorsed by the Executive Board, Ms. Lundsager noted. However, in São Tomé and Príncipe, the initiation of too many projects had led to neglect in the cocoa sector. The authorities were aware of the need to focus on the rehabilitation of the cocoa sector, including the generation of incentives to cocoa producers, and she welcomed their plan to encourage foreign investment. Naturally, the best direct incentive was profit, and the authorities should be urged to price cocoa beans according to world market prices.

Expenditures by the Government had been high, reaching nearly 80 percent of GDP in 1983, Ms. Lundsager observed. The need to cut current expenditure was inescapable, especially in the "wages and salaries" and "other" categories that, according to Table V in Appendix II of SM/84/243, comprised nearly three quarters of current expenditures in the 1984 budget. Implementation of the staff's suggestion that wage increases in the future should be linked to productivity increases would be a first step toward addressing the problem of wages and should encourage labor flows to the cocoa sector. On the basis of a reading of the descriptions of various nonproductive investments, together with the World Bank's views on the authorities' development scheme, some reduction in capital spending seemed warranted, and investments in future should be chosen carefully. A reduced fiscal deficit would permit a more independent monetary policy, including a more active interest rate policy, which should help to increase the domestic savings rate.

While rehabilitation of the cocoa sector should improve the export side of the ledger, and a much-reduced government budget could result in decreased expenditures on imports, the need for an exchange rate adjustment was clear, Ms. Lundsager considered. The extremely large current account deficit could not be addressed through monetary and fiscal policies without further contracting the economy. A currency devaluation would increase the incentive to produce traded goods--including cocoa and other exports--as well as import substitutes, particularly food crops. That incentive should generate employment, offsetting somewhat the contractionary effects of the tight fiscal policy. Furthermore, a devaluation resulting in increased exports to historically important trading partners could reduce São Tomé and Príncipe's growing reliance on bilateral payments arrangements. In general, the need for comprehensive policy adjustments on both the demand management and the supply expansion side would address the authorities' concern about the rapidly increasing debt service burden, which was projected to reach 30 percent of exports of goods and services in 1984, from 6 percent in 1981. If policies remained on their present

track, estimates were that the debt service ratio might reach 118 percent in 1987. Clearly, São Tomé and Príncipe could not manage such a burden. While creditors might be willing to provide assistance as they had in the past, such assistance might be more forthcoming if a sound economic adjustment program were in place. In conclusion, she could support the proposed decision.

Mr. Tshishimbi, after thanking Ms. Lundsager for her comments, said that he assumed that the silence of others was a reflection of their agreement with the thrust of the staff report.

The Chairman made the following summing up:

Executive Directors generally supported the views expressed in the staff appraisal of the 1984 Article IV consultation with São Tomé and Príncipe. In particular, Directors noted that the country was faced with a deteriorating economic and financial performance characterized by negative real growth, large fiscal and external current account imbalances, and rising debt service obligations. They also observed that those developments, as well as the weak prospects for the medium term, were attributable to the long-term erosion of the cocoa base, expansionary fiscal and monetary policies, and the overvaluation of the national currency. In the circumstances, Directors emphasized the need for strong adjustment measures to contain aggregate demand and for effective supply-oriented action to revive production and exports while reducing the country's heavy dependence on imports. In that regard, they stressed the importance of a substantial reduction of the fiscal deficit, to be brought about mainly through cuts in current expenditures--including price subsidies--and greater selectivity in investment projects. Support was also expressed for the authorities' intention to rehabilitate the cocoa sector, and Directors underscored the importance of a substantial exchange rate adjustment, as well as increased productivity-linked incentives--including adequate producer prices for agricultural products--and improvements in manpower and managerial skills.

There was some comment on the weak statistical base in São Tomé and Príncipe and emphasis on the need for immediate action in this area with the assistance of technical expertise by the Fund.

It is expected that the next Article IV consultation will be held on the standard 12-month cycle.

The Executive Board then adopted the following decision:

1. The Fund takes this decision relating to exchange measures of the Democratic Republic of São Tomé and Príncipe subject to Article VIII, Section 2, and in concluding the 1984 Article XIV consultation with the Democratic Republic of São Tomé and Príncipe, in the light of the 1984 Article IV consultation with the Democratic Republic of São Tomé and Príncipe conducted under Decision No. 5392-(77/63), adopted April 29, 1977 (Surveillance over Exchange Rate Policies).

2. The Democratic Republic of São Tomé and Príncipe has continued to maintain restrictions on payments and transfers for current international transactions. The Fund encourages the authorities to apply these measures flexibly and to commence liberalizing them. The Democratic Republic of São Tomé and Príncipe maintains a bilateral payments arrangement with a Fund member; the Fund urges the authorities to terminate this arrangement as soon as possible.

Decision No. 7843-(84/166), adopted  
November 19, 1984

2. OVERDUE FINANCIAL OBLIGATIONS - SIX-MONTHLY REPORT

The Executive Directors considered a six-monthly staff report on overdue financial obligations to the Fund (EBS/84/211, 10/11/84; and Sup. 1, 11/16/84). They also had before them a paper on the effect on income and the treatment in financial statements of overdue financial obligations to the Fund (EBS/84/231, 11/14/84).

Mr. Polak noted the indication of the staff on page 14 of EBS/84/211 that, as a general principle, arrears should be "reported in some way after a certain period, particularly if they are regarded as material." However, the staff had gone on in a footnote to indicate that the question of the materiality of arrears would be discussed in EBS/84/231 at a Board meeting on December 17, 1984. He therefore proposed that the matter of publishing information on overdue payments of members be postponed until the December 17 Board discussion of EBS/84/231.

Mr. Blandin, Mr. Clark, and Mr. Nimatallah supported Mr. Polak's proposal.

Mr. Jayawardena said that, while he saw merit in discussing the various matters outlined on pages 19 and 20 of EBS/84/211, he would prefer that no decision be taken on the recommended modifications. First, as noted by Mr. Polak, the issues in EBS/84/211 had a bearing in some of their aspects on a paper scheduled for discussion on December 17, 1984. Second, while EBS/84/211 was supposed to be a six-monthly report of certain facts, the staff had occasionally gone beyond its terms of reference in making

several recommendations that had a bearing on Fund conditionality. It might be more appropriate if such recommendations were looked at in the context of a separate and more comprehensive discussion.

His third concern related to the list of 29 countries in Table 5 of EBS/84/211, Mr. Jayawardena continued. A great many of those on the list were African countries for which the World Bank--at the most recent Interim and Development Committee meetings--had stressed the need for special understanding. Little space had been devoted in the paper to the special circumstances of those countries that had, in many respects, led to their being in arrears. A closer look at those circumstances might lead to the adoption of a better decision on how to deal with overdue financial obligations to the Fund. Several World Bank studies had been conducted on the impact of the recent recession and external shocks on certain countries, and most of those on the list in Table 5 had featured prominently in those studies. Perhaps the Fund should itself conduct a study of the special problems of those countries on the list or at least pay closer attention to the studies conducted in the World Bank.

A fourth reason why the Executive Board should not adopt any decisions at the present meeting on the matter of overdue financial obligations to the Fund could be found in the Interim Committee's communiqué of September 26, 1983, Mr. Jayawardena said. That communiqué had said, in part, that "in implementing its policies of access to resources, the Fund should be particularly mindful of the very difficult circumstances of the small-quota, low-income countries." The communiqué had gone on to ask the Executive Board to act quickly to take the necessary action in order to implement the conclusions of the Committee. That directive in his view obliged the Executive Board to study the problems of small-quota, low-income countries in the context of a broader discussion before reaching any decisions on matters that could have far-reaching implications for those countries.

Mr. Nebbia stated that his chair could support Mr. Jayawardena's suggestion that the Executive Board not take any decision at the present meeting on the matters discussed in EBS/84/211.

Mr. Nimatallah remarked that he would have difficulty in going along with the approach suggested by Mr. Jayawardena and Mr. Nebbia. If a review of Fund policy made it clear that there were areas in which that policy could be strengthened, then action toward that end should be taken. He saw no value in discussing the issues but postponing decisions until some later date.

Mr. Leonard indicated that he would be content to await the December 17 discussion of EBS/84/231 before taking any decisions on the issue of publicity.

Mr. Clark stated that, like Mr. Nimatallah, his preference was for adopting decisions at the present meeting, except on the question of publishing information on members' arrears.

Mr. Goos indicated that he could go along with both Mr. Clark and Mr. Nimatallah on the issue at hand. In passing, he found it difficult to understand the concerns of those opposed to the adoption of any decisions; the modifications proposed by the staff were strictly procedural and were not at all related to the question of determining whether or not some countries would become ineligible to use Fund resources or whether their access to those resources should be restricted.

Ms. Bush agreed with Mr. Goos that the paper under discussion dealt with procedural matters about which there should be no hesitancy in adopting decisions.

Mr. Nimatallah added that Directors should not be too concerned that the six-monthly report did not go into great detail on the special problems of individual countries. Such countries were afforded any number of opportunities to explain to the Board about the special problems facing their economies. During the present discussion, Directors were being asked to examine procedural changes aimed at strengthening Fund policy on the matter of arrears; if it were apparent that those changes were warranted, the Board should adopt decisions to effect the required changes without delay.

Mr. Zhang considered that there was no harm in postponing decisions on the matters proposed in EBS/84/211 until after the December 17 discussion.

The Chairman asked which of the issues, if any, in EBS/84/211 were related to matters in EBS/84/231 scheduled for discussion on December 17, 1984.

The Treasurer replied that most of the staff recommendations in EBS/84/211 were procedural and were aimed at strengthening existing policies designed to deal with a growing problem of arrears to the Fund. As he saw it, it was only the question of giving publicity to overdue obligations of members that would overlap with the discussion on December 17. In EBS/84/211, the question whether or not to publicize information on members' arrears was a matter of policy; indeed, the staff was recommending no change in the present policy of not systematically giving immediate publicity to the payments difficulties of members. At the same time, as outlined in EBS/84/231, the Fund had certain duties to present a correct and fair picture of its financial condition, which could include the publication of certain factual information on members' overdue obligations to the Fund. The two issues could be discussed together or separately, as Directors wished.

Mr. Nimatallah made the following statement:

As I have said many times, overdue obligations to the Fund are a matter of serious concern to all members. Overdue obligations strike at the Fund's cooperative framework and at the revolving character of its resources. Failure to repurchase on time could weaken the Fund's liquidity. It could also affect the confidence of Fund creditors.

For these reasons, my authorities expect the Fund to formulate a clear and effective policy to deal with this problem. This was their understanding at the time of their recent loan to the Fund. Therefore, I would like the Board to tackle this issue with firmness and determination.

The staff report before us today gives me the following impressions:

1. The report confirms that, by every measure, the problem of overdue obligations has worsened considerably over recent months. The amounts involved have risen; the time for which obligations remain outstanding has lengthened; the number of members with overdue obligations has increased.

2. The report provides little indication that the situation will improve in the near future. Unless appropriate action is taken, the situation could, in fact, deteriorate further, given the large increase in repurchases falling due over the next three or four years.

3. It is not clear from the report how effective the Fund's existing policies have been in controlling the problem. The present policies appear to have worked well in a few cases, but not in others. The formal action taken by the Board, under the procedures agreed in April, has not yet led to significant progress in settling the obligations of three members, in particular, which have been outstanding for more than six months.

These developments are potentially worrying. I, therefore, welcome the staff suggestion to strengthen the existing procedures, as set out on pages 19-20 of their report. However, I believe that more needs to be done. As I suggested in April, the Fund should establish an effective policy, combining firmness with discretion, to safeguard its resources. I proposed then that the Fund should consider a graduated approach that would give members every opportunity and incentive to meet their obligations on time, but leave them in no doubt as to the consequences of not doing so. 1/

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1/ Buff Document 84/51, April 2, 1984.

Recent experience shows that such an approach is needed, particularly for those members that can repay the Fund because they have the financial resources, but are not doing so. This approach incorporates three important principles:

First, this approach would make it more expensive for members not to repay the Fund by introducing a system of penalty charges. Such charges should be imposed at a relatively early stage, and on a rising scale, depending on the time for which obligations are outstanding. This would give members a clear financial incentive to repay the Fund promptly. I would, therefore, like the staff to prepare specific proposals on penalty charges for early Board consideration.

Second, under this approach, the Fund would retain the *option of giving publicity to overdue obligations*. Publicity may not be helpful in all cases. But I believe it could be effective in some cases, particularly those of recalcitrance. Even if publicity is not resorted to except in one case only, this sanction is worth retaining to protect the rest of the Fund membership.

Third, if none of the Fund's sanctions worked, the member would know that the Board could exercise the ultimate option of recommending the member's compulsory withdrawal from the Fund. In such unlikely cases, the Board would, of course, exercise considerable discretion before taking such a serious step. But this sanction should also be available to the Board, as a last resort, in extreme circumstances.

Such an approach would demonstrate the Fund's strong determination to preserve its financial integrity. I am confident that the Board will agree on the need for the Fund to adopt a firm stance on this matter.

Looking ahead, the Fund should not only tackle this problem after overdue obligations have arisen, but also explore ways of preventing overdue obligations. I do not have definitive suggestions at this time. However, I would like the staff to examine the possibilities for introducing preventive measures within the existing framework of consultations with members. The staff should make every effort to anticipate potential problems well in advance and advise members on preventive measures, if necessary. The increasing use of medium-term debt scenarios should also be helpful in this respect.

Furthermore, I attach considerable importance to the treatment of overdue obligations in the Fund's financial statements, and to the implications for the Fund's income and the rate of charge. I note that we will discuss these questions in early December.

In conclusion, I reiterate the position of my authorities that one of the main objectives of the Board should be to keep the Fund financially strong and to ensure that its resources remain secure and revolving. The Fund should therefore adopt a firm stance in dealing with overdue obligations and with any potential threat to its financial standing.

Mr. Ismael remarked that, in considering the problem of overdue obligations to the Fund and in devising procedures to deal with it, Directors should give weight to two important facts. First, only a few members were in arrears to the Fund, and the amounts involved were small in relation to various relevant indicators of Fund activity, which meant that any procedures that might be agreed upon would have only limited application. Second, it was important to maintain a distinction between members whose overdue obligations had arisen from an inability to pay and those that had the means but were unwilling to pay. There was no guarantee that, in either case, a tightening of procedures would result in prompt repayment. In those cases where a member lacked the means to repay and where genuine hardship was involved, the Executive Board should not shy away from providing relief, either by rescheduling the arrears or by allowing the members to pay in their own currencies.

On the recommendations on pages 19 and 20 of EBS/84/211, Mr. Ismael said, the existing time periods relating to the consideration by the Board of complaints and notices by the Managing Director seemed reasonable to give members time to deal with the arrears problem. Still, he had some sympathy for the staff position and could therefore go along with the proposal for an earlier consideration of complaints than had been the practice thus far. He could also go along with the staff's second suggestion that "members experiencing continuous overdue obligations to the Fund be subject to the procedures for complaints and notices, even if no individual payment may remain outstanding for an extended period."

The suggestion for a quarterly review of Board decisions relating to complaints on individual cases was agreeable to his chair, Mr. Ismael continued. However, in view of the heavy work load of Executive Directors, more frequent reviews should be brought before the Board only when it was clear that such action would lead to an immediate resolution of the problem. He had no difficulty with recommendations under which reviews of programs with members in arrears to the Fund would proceed only after the member had become current in its obligations to the Fund. As for the fifth recommendation, the Board should exercise caution in deciding whether or not to give publicity to members' overdue obligations. Causing embarrassment to a member in arrears might not serve to resolve the problem; indeed, it could make matters worse. The staff had argued that, in coming to a decision on the matter, the Board should ensure a certain standard of financial reporting. He would have no objection if such reporting were to be made to the Governors of the Fund, as required under the By-laws; however, he was opposed to the publication of such information in widely distributed Fund periodicals.

The possibility of implementing penalty charges had been discussed in September 1983 and had been rejected by the Board at that time, Mr. Ismael recalled. His own position on the matter remained unchanged: penalty charges would not expedite repayments and could even make them more difficult; moreover, the imposition of penalty charges on members already facing difficult circumstances would be both unfair and unwarranted.

The staff's seventh recommendation entailed a modification of the performance criterion providing that a member, while in arrears to the Fund, could not make purchases under a stand-by arrangement, Mr. Ismael commented. Such a restriction might work as a deterrent in some cases, but it could in other cases remove needed flexibility. For example, suppose that a member had met all performance criteria under a program with the Fund, such that the program was generally on track; if the member then fell into arrears for a relatively small amount, and if prospects were good for an improvement in the member's balance of payments in the short to medium term, there was no reason why the Fund should prevent the member from borrowing in such circumstances. In his view, there could be exceptional cases where it made sense to allow a member to make purchases even when it was in arrears, and the Fund should be sufficiently flexible in its performance criteria to allow the staff to deal with each individual case on its own merits.

Mr. Zecchini observed that the staff's six-monthly report provided the sort of comprehensive analysis that enabled Executive Directors not only to examine in depth the dimensions and characteristics of the "pathology" of the Fund's credit operations but also to establish a firm basis for corrective action. Four developments could be singled out in the report as cause for serious concern: the increase of the share of overdue obligations either in the annual flow of payments or in the stock of outstanding debts during the 1980s; the lengthening of the time before arrears were eliminated; the spreading of the phenomenon among a rising number of countries over the past three years; and the lack of significant results in the few cases where formal actions had been taken. Taken together, those developments led him to share the view of those who felt that the problem of overdue payments had reached the point at which it represented a potential threat to the financial viability of the Fund by slowly undermining the confidence of creditor countries. The only appropriate response to that threat was to strengthen the Fund's procedures along the lines suggested by the staff.

In designing appropriate guidelines, Directors should be guided by the overriding objective of reducing and possibly eliminating all arrears, Mr. Zecchini continued. To that end, it was necessary to create a panoply of conditions that would induce or allow all countries to become current in their obligations to the Fund. Both firmness and flexibility were required: the former for obvious reasons, and the latter to avoid that an unduly rigid attitude by the Fund might widen the gap between the Fund and some of its members and ultimately reduce the probability of repayment.

He fully shared the view often stressed in the Board and forcefully reiterated by Mr. Nimatallah that arrears to the Fund constituted a potential threat to the financial viability of the Fund insofar as the institution's credibility was based on the confidence of creditor countries, Mr. Zecchini commented. Hence, he agreed that the appropriate response to the increasing problem of arrears should be a strengthening of procedures along the lines suggested by the staff.

Of the topics for discussion and recommendations outlined on pages 19 and 20 of SM/84/211, those in paragraphs 1, 2, and 7 were particularly important, Mr. Zecchini considered. A number of countries were experiencing continuous overdue obligations, with no individual payment outstanding for an extended period. Those countries tended to benefit from the time that it took to implement the current procedures, obtaining a de facto rescheduling at low cost of some of their obligations. The tendency of countries to take advantage of the procedures should be resisted, and he would support the proposal to apply to those members a course of action similar to the one envisaged for longer-term arrears. A member's not being current with the Fund was of serious concern, regardless of whether the arrears represented a single obligation or several. For the same reason, he saw no merit in applying to the "rollover" case the longer grace period of six months before any action was taken. The problems that could arise could best be shown in the example of two countries that fell into arrears at the same time for the same amount except that, after three months, the first country substituted, for the initial obligation, another of the same amount. If the staff's proposals in paragraphs 1 and 2 on page 19 were to be accepted as written, the Managing Director would issue a complaint against the second country but not against the first, even though the two countries were in the same situation in terms of their financial relations with the Fund. The procedures should be designed to prevent such differences from arising.

On the recommendations in paragraph 2, Mr. Zecchini observed, a number of countries had been in arrears to the Fund for a rather long time for reasons that ranged from inability to pay to unwillingness to pay. He doubted that a preliminary period as long as five months would be of any help in placing such countries in a more favorable position to make their overdue payments; on the contrary, there were advantages for the Executive Board in being able to examine the matter as promptly as possible, listening to the country's statement of its case, and perhaps making use of the flexibility that only the Executive Board itself was in a position to apply. For all those reasons, he could support a shortening of the initial period from five to three months.

Paragraph 7 on page 20 covered the crucial question of the extent to which overdue payments should affect the access of members to Fund resources, Mr. Zecchini noted. As a general principle, and excepting any flexible approach that the Executive Board might wish to exercise, a country that was not current with the Fund should not be allowed access to Fund credit in any form. Hence, he could agree to the restrictions recommended in paragraph 7 applying to both stand-by arrangements and the special facilities,

and including first credit tranche purchases. If it were decided to adopt such an approach, Directors should clearly understand the role of any subsequent Board decision on the substance of the matter in question. By a simple application of the procedures, a limitation on the use of Fund resources by the member would already be in force; however, the Board would have the flexibility to exercise several options ranging from the lenient to the more punitive. First, the Board could, in special circumstances, authorize access to some forms of Fund credit. Second, the Board could decide to limit the use of resources, as had been done in the past on the basis of Rule K-2, thus confirming the status quo, although the Board could draw a distinction by giving some form of publicity to the decision. Finally, the Board could proceed with a formal declaration of ineligibility. In sum, accepting the suggestions in paragraph 7 would amount to adopting an intermediate course of action as soon as arrears developed and should in no way hamper the discretionary power of the Executive Board to exercise whatever flexibility it wished. He hoped that the staff could confirm his understanding of the operation of the procedures recommended in paragraph 7.

On the remaining recommendations, Mr. Zecchini agreed that reviews should normally be made every three months and that program reviews should not be conducted with members that were not current with the Fund. The publicity question should, as others had suggested, be dealt with on December 17 in connection with the scheduled discussion of the effects of arrears on the Fund's income and financial statements. On the matter of penalty charges, while he was certainly in favor of tightening procedures, he could not advocate the introduction of penalty charges at present, although the matter should be kept under review so that such charges could be implemented at a later stage if that was considered necessary. Finally, on a technical and perhaps presentational point, he noted that, while it was clear that the amount of overdue payments to the Fund had increased in relation to outstanding Fund credit and that the number of countries in arrears had also increased, the staff had not provided any comparative data, such as some measure of overall arrears in the international financial system. It would be interesting to know whether the Fund was accumulating more or fewer arrears than other creditors, either public or private. That information might be relevant to the deliberations of Directors, particularly considering that tighter rules by the Fund, for given financial conditions of the debtor countries, could produce results partly at the expense of other creditors.

Mr. Schneider stated that, like others, he was concerned about the increasing tendency in recent months toward overdue payments. The timely fulfillment of financial obligations was an essential part of commitments undertaken by members in the framework of arrangements with the Fund. Delays in meeting those obligations, even those due to administrative problems, should therefore not be tolerated. To prevent their occurrence, sufficient advanced knowledge should be given to members to enable them to discharge their obligations in a timely manner. Also to be borne in mind was the likelihood that overdue payments would increase even further during the coming period when the Fund was gradually reducing the level

of its commitments to member countries, which might then find themselves faced with a negative transfer of resources vis-à-vis the Fund and might find it increasingly difficult to repay the institution. Despite the procedures adopted by the Executive Board in April 1984, the problem of overdue financial obligations to the Fund had become more acute than it had been only one year previously, and there was thus a need to strengthen present policies and procedures.

On the recommended modifications embodied in the seven paragraphs on pages 19-20 of EBS/84/211, Mr. Schneider noted, first, that it was essential that the problem of overdue payments be tackled promptly before it had a chance to grow to such proportions that treatment became difficult. In that respect, the staff's proposal to shorten the time period for the submission of reports, complaints, and notices by the Managing Director seemed to be a step in the right direction, although care should be taken not to go too far. It was important that the new proposed guidelines leave sufficient time for member countries to engage in discussions with the Fund to find ways and means of settling their arrears. In passing, he was uncertain about the desirability of incorporating, in the determination of the timing to be imposed on each individual case, expectations concerning the amount of time that a member would need to prepare its reply. The Fund might be treading dangerous ground if it were to become involved in making judgments about the preparedness, or lack of it, of members. In general, and given the potential problems that he had outlined, he agreed with the staff that the Board should retain a fair degree of flexibility in dealing with arrears. Experience had shown that such flexibility was warranted; in that regard, the suggested procedures should be viewed as guidelines rather than strict rules.

The problem of members experiencing continuous arrears was a serious one since, in effect, the Fund ended up financing those arrears with a sort of "revolving credit," Mr. Schneider remarked. Hence, he could endorse the approach outlined in paragraph 2 on page 19. As he understood it, once the initial complaint had been considered by the Board, cases of continuous arrears would be treated in the same way as those in paragraph 1.

He agreed with the staff recommendation in paragraph 3 that the Executive Board should review its decisions on complaints in light of developments so that heavier sanctions could be imposed in cases where no progress had yet been achieved, Mr. Schneider commented. Such reviews should by no means be regarded as grace periods, however, since they would lead to heavier sanctions unless considerable progress had been made toward satisfying the obligation. He also agreed with the recommendation in paragraph 4 that arrears should result in suspension of discussions on the use of Fund resources, including program review discussions under a particular arrangement, until the member was current in its obligations to the Fund. That should not, of course, apply to discussions with the staff aimed at finding ways and means for the member to overcome its payments difficulties. In that respect, he could fully subscribe to the staff's view on the postponement or rescheduling of Fund obligations, since he saw no considerations that would invalidate such an approach.

On the issue of publication of information on members' overdue obligations, Mr. Schneider said, while he was cognizant of the significant impact that such information might have, he had doubts about the value of publishing it as a solution to the problem of payments arrears. Publishing information on members' overdue obligations could raise serious questions-- both in the mind of the public and in international financial circles-- about the Fund's competence. In the circumstances, publicity for such information should be considered only as a last resort, and even then should be handled with great caution. More effective and less potentially damaging disincentives to the maintenance of arrears surely must exist. On the other hand, and consistent with good accounting practices, he was not opposed to the appropriate reflection in all relevant Fund publications of overdue payments that had been outstanding for more than six months.

In responding to the problem of arrears, the Fund had so far limited itself to adopting decisions preventing certain members from making further use of the Fund's resources, Mr. Schneider noted. It was not surprising that such an action had not, in and of itself, served to reduce the problem of overdue payments to the Fund; that it had not done so clearly illustrated the seriousness of the problems that members were facing with respect to the discharge of their obligations to the Fund. At the same time, those members simply unwilling to discharge their obligations were unlikely to be motivated solely by a limitation on their use of Fund resources. To be convincing, the Fund's approach in such cases needed to incorporate increasing sanctions when satisfactory solutions failed to materialize. In that respect, he was not certain that penalty charges would be an effective means of alleviating the arrears problem--and was thus not particularly in favor of implementing them--but he would be prepared to review a staff paper that examined in detail the question of penalty charges and various other options open to the Fund. He agreed with the staff that, in cases where no progress had been made, the Board would in due course be compelled to consider declaring the member ineligible to use Fund resources and might ultimately have to withdraw the country's right of membership. However, the Fund should not attempt to define procedures or criteria that would lead to such measures; rather, it should examine each case on its own merits and adopt appropriate decisions on an ad hoc basis.

He could also agree with the staff's proposals regarding the establishment of performance criteria on overdue payments, Mr. Schneider concluded. When a member was in arrears, it had failed in its general obligation to discharge its debt to the Fund, no matter whether the indebtedness originated from a drawing under an arrangement or from the use of special facilities. In cases of arrears, the member should not be entitled to use any resources of the Fund, and the performance criteria should be adjusted to give effect to that intention, which would imply a change in paragraph 6 of the proposed guidelines on corrective action on misreporting and noncomplying purchases under Fund arrangements. It remained important to make a clear distinction between the repurchase expectation following a noncomplying purchase under a specific arrangement and the problem of overdue payments in general. In sum, he saw a need to make some changes

in Fund policies in order to strengthen the procedures for dealing with the problem of overdue obligations to the Fund. However, in so doing, Directors should be careful not to go so far as to preclude the possibility of discussions between the member and the Fund on ways and means of resolving the problem. Finally, he understood that it was World Bank policy to stop making disbursements to all members in arrears to the institution; he wondered whether the Bank undertook any specific positive actions, beyond words of encouragement, to induce members to fulfill their financial obligations.

Mr. Jayawardena said that he was happy to note from the staff report that, notwithstanding the recent increase in overdue obligations, the incidence of such occurrences had not been widespread. He was also glad to see that failures to make regular on-time payments to the Fund had been confined to "only a small number of members" and that "the problem does not at this time require consideration of fundamental shifts in the Fund's policies and procedures on overdue payments."

Early in its report, on page 3, the staff had made a number of important observations that deserved to be quoted in full, Mr. Jayawardena continued. Among those observations were the following:

Although broader world economic developments may have been a factor contributing to their problems, in most cases these members have faced extended difficulties of economic management, evident well before the emergence of the world economic recession and widespread debt difficulties. In a few cases, recent problems in meeting obligations to the Fund have been associated with inadequate progress toward a viable balance of payments position despite repeated adjustment programs and prolonged periods of use of Fund resources; for some of these members, obligations to the Fund have become a major factor in their overall debt and debt service problems. These members have not been able to benefit to the same degree as many others from the recovery in world trade and economic activity now under way; in fact, in some cases, deepening problems in meeting their obligations to the Fund and other creditors have been encountered.

He found it difficult to understand why that passage had not been supported with empirical evidence and why its logic had been left unpursued; both failures made it difficult for Directors fully to appreciate the problem under discussion. It would be illuminating, for example, to know how many countries in arrears had had repeated adjustment programs and why they had still failed to pay on schedule. Normally, members seeking adjustment programs were willing to subject themselves to Fund discipline; when members fell into arrears, the appropriate course of action to follow would be to explore ways and means of providing additional or different types of support, so as to enable them to become current in their obligations to the Fund. Unfortunately, the staff had chosen to propose stricter

or tighter procedures for eliminating arrears, even after conceding that there was no need for a fundamental revision in the Fund's existing policies and procedures on overdue payments.

Tightening procedures through some definite guidelines would affect the relationship between the Fund and its members and could reduce the flexibility of the institution in dealing with the problem of arrears, Mr. Jayawardena considered. He was particularly concerned that the existence of only one member in "continuous" arrears had led to the view that small, continuous arrears to the Fund should trigger the initiation of special procedures for dealing with overdue payments. Any action proposed for dealing with arrears should be consistent with the international character and cooperative spirit of the Fund and should not adversely affect those elements. No one was condoning overdue payments or suggesting that the Fund should be lax in dealing with the problem; indeed, firm action should be taken against any member that was recalcitrant in repaying its debts. However, where arrears occurred because of factors beyond the member's control, the responsibility of the Fund was to look closely into the economic circumstances of the member and to take measures that would encourage and help that member to settle its obligations.

He failed to understand how the imposition of penalty charges on overdue payments would help to reduce the problem of arrears, Mr. Jayawardena remarked. Indeed, the Fund would only compound the situation by levying penalty charges on members that were unable to pay even their normal dues. He also could not support the suggestion for giving immediate publicity to any Board action taken vis-à-vis a member in arrears. Such publicity could damage the creditworthiness of the member and could lead to a deterioration in the relations between the member and the Fund.

In matters regarding the use of Fund resources, the staff had recommended that the Fund not proceed with scheduled reviews of a program if the member had fallen into arrears, even if the program appeared to be on track on all other counts, Mr. Jayawardena commented. He wondered whether a decision to interrupt a review of a program that was on track, merely because of an emergence of arrears just prior to the review might not disturb both the timing and the momentum of the program. He saw no reason why a scheduled review should not be conducted, on the understanding that it would be brought to the Board for consideration only when the member became current in its obligations. On a related matter, while he would not wish to encourage rescheduling of obligations to the Fund as a general practice, he noted that there was a provision in Article V, Section 7(g) for postponing repurchases in exceptional cases on the basis of a 70 percent majority of the voting power.

With regard to the suggestion for giving publicity to information on overdue financial obligations to the Fund in the Annual Report, International Financial Statistics, and other publications, it was important to take into account not only the size of the arrears but also the length of time that

they had been in existence, Mr. Jayawardena said. The staff had suggested publishing information only on arrears that had existed for at least six months but had made no mention of how large the arrears should be to merit publication. In his view, the incidence of overdue financial obligations to the Fund had not been sufficiently serious or frequent to warrant special mention in Fund publications, even after six months.

In April 1984 (Decision No. 7678-(84/62), 6/20/84), the Board had approved a provision whereby, when a member had overdue obligations to the Fund, its right to purchase under a stand-by or extended arrangement would be interrupted if the purchase resulted in an increase in the Fund's holdings of the member's currency in the credit tranches beyond 25 percent of quota, or if the purchase of borrowed resources resulted in raising the Fund's holdings of the member's currency beyond 12.5 percent of quota, Mr. Jayawardena recalled. In EBS/84/211, the staff was proposing modifications to that provision under which (a) no purchase whatsoever in any credit tranche under standby or extended arrangements would be made by a member in arrears to the Fund, and (b) no purchase under special facilities would be made by a member in arrears. In support of its proposed changes, the staff had outlined a hypothetical situation under which a member might make a first drawing on a date when it had arrears, even though it had been current with the Fund when the arrangement had been approved. Such a situation had not thus far arisen in the history of the Fund, and it would be unfortunate if hypothetical arguments about a possible "stealthy" use of Fund resources were to lead to a hardening of attitudes toward members in arrears, a prospect that in fact seemed to be developing.

As he understood it, problems arose when arrears emerged in members under arrangements with the Fund because "the use of Fund resources is not to be discussed with members while they are in arrears to the Fund," Mr. Jayawardena remarked. He wondered how many members in arrears and under Fund arrangements had the luxury of having Fund holdings of their currencies below 25 percent of quota or below 12.5 percent when purchases were made of borrowed resources. In that regard, he would appreciate learning from the staff how many countries during, say, the past two years, had been able to make drawings on the first tranche during a Fund arrangement. His guess was that, in general, they would have drawn more than 25 percent of quota by the time they were well into the Fund arrangement. Exceptions might exist, of course, but the question was whether or not special rules and procedures were needed to deal with such rare instances, especially when those new procedures could adversely affect all members in the final analysis. He was frightened by the prospect of seeing a hardening of attitudes toward members in arrears, especially when most of those members happened to be low-income countries with practically no access to commercial markets. All members should be encouraged to meet their obligations, but the Fund should work toward that end by helping members to improve their economic lot rather than by subjecting them to rigorous procedures and additional conditionality. In fact, it was precisely such a positive approach that had been recommended by the Interim Committee in September 1983; unfortunately, he had yet to

see any meaningful progress toward implementing that recommended approach. It would be a sad day for the Fund if even one member failed to pay its obligations--not because it was recalcitrant but because it suffered from a harsh economic environment--under a regime of tightened procedures and additional conditionalities and if it were in the end compelled to withdraw from membership in the institution.

He saw no reason for modifying the present provisions regarding the performance criteria in the stand-by and extended arrangements, Mr. Jayawardena said. Use of Fund resources in lower credit tranches and under special facilities, without conditions, had long served the temporary and specific needs of members in balance of payments difficulty and should in no way be cut back at present. For those reasons, it was not appropriate in his view to link the proposed Guideline 6 in EBS/84/196, Supplement 2 (11/14/84) with the proposals in EBS/84/211 concerning the provisions to be met in performance criteria. His chair firmly believed that it was important to require an 85 percent majority of total voting power for Guideline 6 on misreporting and noncomplying purchases to be legally valid. Moreover, his chair believed that it was the moral obligation of the Executive Board to ensure that an expectation did not turn out to be an obligation in practice, which was apparently what would happen if Guideline 6 were accepted. To impose an obligation, which required an 85 percent majority, through an "expectation" route--which required only a simple majority--would be inappropriate sleight of hand; hence, he urged that Guideline 6 be deleted.

Of the 29 countries listed in Table 5 of EBS/84/211, 20 were from sub-Saharan Africa--a region devastated by drought and other economic misfortunes--and had little or no access to financial markets, Mr. Jayawardena observed. An international effort was currently under way to help the countries in that region; indeed, at the most recent Interim and Development Committee meetings, a special program for sub-Saharan Africa had been discussed, and many countries were working to tackle the problems of massive starvation and death in the region. It seemed odd in that context for the Fund to be tightening conditions for those countries at a time when greater understanding should be shown.

There seemed to be a distinction between the Fund's attitude toward large debtors--with liberal access to capital markets--and its attitude toward small countries with little or no access to capital markets, Mr. Jayawardena commented. When the commercial banks had cut off resources to the larger debtors, the Fund had moved in, encouraging rescheduling of debts and requesting the commercial banks to maintain an increased flow of resources. Unfortunately, the Fund's approach to the smaller debtors with limited access to capital markets had been quite different, even though the Interim Committee had directed the Fund to be particularly mindful of the problems of such countries. At a time when more than 20 million people were reported to be dying of starvation and when the entire world was attempting to support those unfortunate countries left devastated by the recent recession, the Fund seemed to be contemplating the implementation of procedures that would only make life more difficult

for those countries by denying to them what had thus far been unconditional Fund assistance and by depriving them of access to financial markets. Indeed, the Fund appeared to be forsaking those countries in their most difficult hour. In sum, the matter of overdue financial obligations should certainly be studied, although not from the point of view of the proverbial "moneylender" attempting to devise whatever means possible to recover his loans at any cost; rather, any study should recognize the Fund as an institution of international cooperation, should determine why the affected countries were unable to pay, and should devise ways and means of helping them to meet their obligations.

Mr. Nimatallah said that there appeared to be some misunderstanding of the position of those who wished to improve existing procedures. No one was calling for the elimination of flexibility, which was particularly important in cases where harsh circumstances were preventing some members from meeting their obligations. However, the procedures should be sufficiently tight to deal firmly with those countries that choose freely not to meet their obligations. It was in that respect that he had proposed the implementation of penalty charges as a way of encouraging recalcitrant members to repay. He recognized that some of his colleagues were not convinced that penalty charges would produce the desired results; perhaps those Directors should practice what they preached and be flexible enough to allow the implementation of penalty charges during a testing period. If it turned out that such charges failed to encourage repayment, they could be canceled.

The Chairman remarked that Directors should be cautious about attempting to establish a relationship between repayment obligations and the source of hardship and economic stress on which Mr. Jayawardena had placed emphasis. If the effort to establish such a relationship relied on the argument that the Fund should be more lenient in demanding repayment from those countries suffering economic and financial difficulties, there were those in the Fund who would ask whether it was appropriate for the institution to become involved at all with countries experiencing basic structural difficulties. He himself had for a number of years insisted that it was the responsibility of the Fund to help such countries, on the understanding that the type and amount of assistance that the Fund could provide was appropriate to the members' circumstances and that it was repayable. Any suggestion that countries in very dire straits might in some way be exempted from their obligations could easily lead to the argument that such countries were not eligible for assistance by the Fund in the first place, a notion that could severely damage the collaborative effort of the Fund and others to put member country economies back on the right track. He continued to feel that it was important for the Fund to maintain its catalytic and supportive role in conjunction with other financial institutions or donor countries; he believed that it was wrong even to suggest that, because of the difficulties and poverty of some countries, their obligations should be forgiven.

Mr. Nimatallah stated that it was in the context of the Chairman's latest remarks, with which he fully agreed, that he had some difficulty with Mr. Zecchini's request for comparative data on arrears of other organizations. In his view, the Fund was a unique organization playing a very special role in the international monetary system, and it should therefore be treated in a very special way.

Mr. Jayawardena agreed with Mr. Nimatallah that the Fund should invoke all provisions available to it to pressure recalcitrant members to meet their obligations to the Fund; however, no additional conditionality was necessary for that purpose. He was worried that Directors were using one or two recalcitrant cases as examples of why new or tighter rules should be applied to all members. The decisions being contemplated had serious implications for the membership of the Fund, which was why he had urged Directors to take a closer look at the circumstances of those members listed in Table 5 of EBS/84/211. One example from a recent World Bank study might serve to demonstrate the importance of a further examination of such circumstances: the study showed that Jamaica, one of the countries on the list, had suffered a 21 percent decrease in GDP over the past three years because of external shocks. He found it difficult to understand how a country experiencing such difficulties could be expected at the same time to meet its financial responsibilities to its creditors. Moreover, given that the world had been suffering from the worst recession in 50 years, it was only natural that the record of meeting repurchase obligations would have suffered over the period.

Mr. Zecchini commented that, while there were certainly special problems being experienced by some members in arrears, those did not change the basic nature of the Fund, which was a monetary institution. That fundamental nature of the institution had to be preserved; and, if the financial support required by countries could not be provided by the Fund, then other institutions would have to fill the need.

On another matter, he had not been asking earlier for comparative data showing similarities and differences between the Fund and other institutions with respect to their experience with arrears, Mr. Zecchini continued. Rather, his main interest was in seeing whether debtor countries discriminated among creditors in fulfilling their obligations.

Mr. Polak observed that overdue payments at end-September 1983 had become three times as large as they had been only one year previously and that the problem at present was even more serious than when it had been discussed in April 1984. The formal actions instituted in April seemed to have led to some success in the fight against arrears by comparison with the rather informal procedures that had earlier been in place. In at least three or four cases, some payments had been received, and one member had paid in full. Of course, that progress had to be set against the observation that, given the difficult situation of many member countries, there was no single procedure that could be adopted to eliminate the problem of arrears. Hence, for the time being, Directors should follow the procedures agreed six months previously, perhaps adding some

improvements to make them more effective. In that regard, he could agree to the staff's suggestion to speed up the timetable relating to consideration by the Executive Board of complaints and notices by the Managing Director. He could also agree that the Fund should apply to members experiencing continuous arrears, even if no individual payment had remained outstanding for an extended period, the same procedures for complaints and notices recommended in paragraph 1 on page 19 of EBS/84/211. Finally, he accepted that quarterly reviews would be useful. There was no need at the present stage to adopt any additional measures; for example, he saw little benefit in a penalty interest rate--which could be interpreted as an acceptance of the arrears so long as the interest was paid--and considered that there would be little merit in publicizing information on members' arrears. Of course, if the Fund were to declare a member ineligible to use the Fund's resources, that declaration should be made public.

The relations between the Fund and members in arrears had been discussed at great length on pages 8 and 9 of EBS/84/211, but no firm conclusions had been drawn, Mr. Polak continued. In his view, the matter was a simple one: a member in arrears could not use Fund credit to repay the Fund. By the same token, a member should not be able to conclude a new stand-by arrangement with the Fund while it was in arrears; nor should the Fund conclude a review with a member in arrears. However, it did not follow from those principles that discussions on a review should be interrupted; it was only that they should not be brought to the Board for a decision. It was important for the Fund to maintain contacts with such a member. It should be remembered that, in some cases, the removal of arrears might necessitate the adoption of a program that would permit the member to find bridge financing to pay the Fund so that it could then transform the program into a new Fund arrangement. While it was important to follow the principle that there should be no Fund financing until arrears were paid in full, the Fund should be careful about adopting a punitive attitude toward members that were making an effort to pay off the arrears. The risk was that a constructive solution to the member's problems might be delayed because the member was needlessly deprived of potential Fund support.

Mr. Abdallah observed that the problem of overdue payments to the Fund had, since April 1984, increased somewhat in both size and complexity. There had also been a lengthening of the period during which arrears had remained overdue. Those increases were a reflection of the fact that the global recession was continuing to have an adverse effect on the developing countries. However, despite the continuing problems facing many members, the incidence of overdue payments to the Fund was not widespread; he hoped that, with improvements in the international economic environment and the adoption of appropriate adjustment measures, the staff's next six-monthly report would not reveal a further deterioration in the situation. He agreed with the staff that, at present, the problem did not require a fundamental shift in Fund policies and procedures on overdue payments, even though certain modifications might be necessary to ensure the effectiveness of current policies and procedures.

As to the seven suggestions for change outlined on pages 19-20 of EBS/84/211, Mr. Abdallah said, he had no difficulty with the recommendations in paragraph 1. In paragraph 2, he agreed with the staff that the Executive Board should be specifically informed in future of cases of continuous arrears. However, he did not feel there was any need for a formal decision applying the procedures recommended in paragraph 1 to those cases of continuous arrears; as the staff had indicated, only one such case existed at present. Besides, the fact that no obligation remained outstanding long enough to trigger a complaint was an indication that the member was doing its best to pay its arrears.

Executive Board reviews of decisions on complaints should become a standard feature of Fund procedures, Mr. Abdallah suggested. An initial limit of three months seemed reasonable, but it should be subject to renewal, either for a similar or shorter period, depending on the circumstances of the country concerned. As to the recommendations in paragraph 4, he could understand the concerns of the staff about ensuring uniformity of treatment of members. However, the staff should proceed with reviews of programs with members in arrears while making it clear to the authorities that the reviews would not be completed by a Board discussion, and would therefore not lead to any drawings, so long as the arrears remained. The existence of arrears should not preclude the member from benefiting from Fund expertise on how best to strengthen the existing program through a review. When the Fund was in a position to undertake an Article IV consultation or to send special missions to a country in arrears, there was no reason why a scheduled review should be suspended. In the final analysis, all contacts with the member served the same purpose, namely, to find ways and means of resolving the member's difficult payment problems so that it could become current in its obligations to the Fund.

He could support those who were willing to postpone the publicity question until after the December 17 discussion, Mr. Abdallah continued. On the matter of penalty charges, outlined in paragraph 6, the position of his chair remained unchanged from what it had been in April 1984: the imposition of penalty charges would unnecessarily increase the burden on countries that had found themselves in arrears to the Fund and would not improve their prospects for the immediate future. In his view, the Fund should be exploring ways of alleviating the burden rather than adding to it.

He found it difficult to accept the recommendations in paragraph 7, which seemed to represent a fundamental change in policies and procedures, Mr. Abdallah remarked. In his view, a member's access to the special facilities and to first credit tranche resources outside stand-by arrangements should not be denied when the a member was in arrears. Moreover, the staff had dealt at great length with the postponement of obligations to the Fund as provided for under the Articles of Agreement, but it had made no reference to that issue in its summary and recommendations. Without advocating general use of the mechanism of postponement, he believed that there might be occasions when such a course of action was warranted. He agreed with the staff that the burden of proof of a need

for postponement rested with the debtor country. Unfortunately, it was one thing to establish such a need; it was another for the Board to agree to the postponement.

It had to be understood that few if any countries enjoyed being in arrears, particularly to the Fund, which was such an important institution in the international monetary system, Mr. Abdallah concluded. It was only proper that attention should be paid to the concerns of creditor countries, concerns that had been eloquently outlined in Mr. Nimatallah's statement. At the same time, the problems of borrowing countries must not be overlooked, and care must be taken not to adopt a general procedure for dealing with arrears that was too restrictive or too punitive.

Mr. Nimatallah observed that his preference for a tightening of procedures was based on a desire to protect the International Monetary Fund and the revolving character of its resources.

Mr. Tvedt remarked that overdue obligations to the Fund were not new, and the incidence of overdue payments was not widespread. Nevertheless, the trend toward an increase in the number of members in arrears and toward a lengthening of the duration of such arrears was troubling. He presumed that the trend essentially reflected the payments problems related to large current account imbalances and was only to a lesser extent due to negligence on the part of members. In the circumstances, he could agree with the staff that no major change was needed at present in the Fund's policies and procedures for dealing with overdue financial obligations. He had no difficulty going along with a modest tightening of the timing and the procedural guidelines as proposed by the staff, a change that he hoped would contribute to prompt payments by members while ensuring uniformity of treatment.

In addition to reacting promptly to delays in individual payments, the Fund's management should report to the Executive Board on what the staff had described as "continuous arrears," Mr. Tvedt commented. Such arrears should be handled with the same determination required for dealing with individual arrears, although he could go along with the proposal to allow for a somewhat longer period for initiating complaints. He could also support the staff's proposal to make Executive Board reviews of its decisions on complaints a standard feature of the procedures.

With regard to a member's right to draw on Fund resources while in arrears, Mr. Tvedt indicated that he could support the proposed change in the performance criterion that prevented members with overdue obligations to the Fund from making purchases in the credit tranches or from borrowed resources as well as under the special facilities. Similarly, the staff should refrain from discussions of further use of Fund resources with members in arrears to the Fund. His preference was to be cautious about imposing penalty charges on overdue payments, which could be interpreted as legalizing the overdue obligations. Finally, he would be hesitant about publishing data on individual countries' overdue payments to the

Fund. Such an approach might prove harmful to the creditworthiness of the member concerned, even after it had become current with the Fund. Besides, he understood that the Board would hold a separate discussion on December 17th on the publicity question as part of its consideration of the effect of overdue obligations on the Fund's income and their treatment in financial statements.

Mr. Leonard stated that, like others, he found the continuing growth in overdue obligations to the Fund to be disturbing. While the amounts in absolute terms were still fairly small, the trend pointed to dangers ahead. Unless the Fund were successful in curbing that trend, the incidence of arrears in the not too distant future could adversely affect the Fund's liquidity position and could complicate the Fund's own repayment obligations with respect to resources under the enlarged access policy.

During the previous meeting on the matter (EBM/84/54, 4/5/84), the Executive Board had decided that the appropriate response to overdue obligations should not be rescheduling or the provision of new financing but rather renewed emphasis on adjustment measures that permitted the member to honor its obligations, Mr. Leonard said. His authorities continued to believe that such an approach was appropriate. They recognized that some countries in arrears faced difficult economic circumstances, owing in part to international developments beyond their control. Nevertheless, other countries facing similar conditions had been successful in meeting their obligations to the Fund on time. Since many of the countries in arrears had had a history of weakness in economic management both prior to and during arrangements with the Fund, some questions arose about their commitment to adjustment. It was probable that a firm line on arrears would help to strengthen that commitment more than would any other action by the Fund. To those who felt that the staff had taken a very hard line in its recommendations in EBS/84/211, he would argue that the Fund should be viewed as a specialized "instrument" capable of aiding its members, both rich and poor, under fairly restricted circumstances. All members must thus be careful how the instrument was used. If it were abused through slippages allowed by a lenient attitude toward arrears, the Fund could lose its credibility, even in the restricted area of its operations.

He could accept the view of the staff that, in present circumstances, no fundamental shift in policy on overdue obligations was required, although a general tightening of existing procedures was justified, Mr. Leonard commented. The Fund should maintain the principle of uniform treatment of members, even with respect to its treatment of members in arrears; with that idea in mind, it was preferable to ensure that the relevant procedures were applied in a fairly automatic fashion, albeit with provision for the possibility of changes in exceptional circumstances. Accordingly, he could support the proposal to shorten the periods relating to consideration by the Executive Board of complaints and notices by the Managing Director and for the initial Board discussion of the complaint. In addition, he could accept that a review conducted three months after a Board decision on a member's overdue obligations was appropriate as a way of keeping the Board informed of the member's efforts to eliminate its

arrears and of providing an added incentive for the member to become current in its payments. On a related matter, since continuous arrears were in his view equivalent to a postponement of payment, they should be discouraged. He could therefore accept that a complaint on continuous arrears should be circulated even more quickly than six months after the obligation became overdue. However, he was prepared to accept the proposed six-month time limit if others felt that was appropriate.

In April 1984, most Directors had considered that members should not be able to draw on Fund resources under arrangements while in arrears to the Fund, even if the Executive Board had not yet adopted a formal decision limiting a member's use of such resources, Mr. Leonard recalled. He could therefore support the staff's proposal for a consistent application of that policy. Performance criteria should be modified to ensure that no purchases in the tranches or of borrowed resources occurred while arrears existed. Furthermore, in order to protect the revolving nature of the Fund's resources, members in arrears to the Fund should not be permitted to draw under the special facilities or in the first credit tranche.

To ensure uniformity of treatment of members, reviews of conditional programs should proceed only if a member was current in its obligations to the Fund, Mr. Leonard considered. That did not mean, of course, that dialogue between the Fund and the member should be curtailed; indeed, an effort should be made to review various aspects of the economy of a member in arrears with a view to finding ways of eliminating those arrears.

He did not find compelling the argument that the imposition of penalty charges would encourage member countries to meet their overdue obligations to the Fund, Mr. Leonard remarked. However, he was prepared to give further consideration to the matter, perhaps on the basis of a separate staff paper. With regard to the publicity question, he agreed with those who felt that there was merit in more systematic reporting of arrears as a means of reinforcing and ensuring the Fund's financial integrity in the international community. At the same time, he was not convinced that wider publicity of a member's arrears would speed their settlement; while he could accept that the Board should retain the option of publicizing such information as a punitive instrument, he hoped that it would be used sparingly. In any event, as he had already indicated, a decision on the publicity issue might better be taken at the conclusion of the December 17 discussion on the effect of overdue financial obligations to the Fund on the Fund's income and the treatment of those obligations in the Fund's financial statements.

In conclusion, Mr. Leonard said, the best way of dealing with overdue obligations was to prevent their occurrence in the first place. He welcomed the fact that, in formulating and reviewing adjustment programs, the staff was giving increased attention to identifying potential problems that members might face in meeting their obligations to the Fund. He would be happy to see, in addition, some emphasis on how conditionality could be successfully applied in order to prevent the accumulation of arrears.

Mr. Yamashita stated that he too was concerned about recent increases in the amount of overdue obligations to the Fund. He had been struck in particular by the fact that the number of members in arrears to the Fund during January-September 1984 had been equivalent to one sixth of those with outstanding use of Fund credit during the same period. The existence of overdue payments was contrary to the purposes of the Fund and could lead to the impairment of its credibility; hence, he could fully support the comprehensive approach aimed at further clarifying and strengthening the policies and procedures for dealing with overdue obligations.

On whether a scheduled review of a member's program should proceed when a member was in arrears to the Fund, Mr. Yamashita noted, he had been persuaded by the staff's argument that the conduct of review discussions in such circumstances seemed to allow further delay in clearing the member's arrears to the Fund. Hence, a review of a program with a member in arrears should proceed only if the member became current with the Fund; however, like Mr. Polak, he believed that other types of contact between the staff and the member should continue.

The April 1984 Board discussion of overdue financial obligations had shown that, while penalty charges might be effective in certain cases, especially where the delays in payment were of a technical nature, such charges might only exacerbate the problem of arrears in other cases, Mr. Yamashita commented. He had been interested in the suggestion at the time that penalty charges should be used at least to cover the implicit cost involved in payments delays, and, in that respect, he would welcome a staff paper that examined in detail the question of penalty charges. Perhaps the examination of that subject could be combined with a study of other possible options aimed at encouraging members to eliminate their arrears.

Finally, with respect to the proposed modification of the performance criterion on overdue obligations to the Fund, Mr. Yamashita indicated his belief that the intention of the Board was not to permit drawings by a member whenever it was in arrears to the Fund. Hence, he could support draft decisions that would serve to implement the staff's recommendations in paragraph 7 on page 20 of EBS/84/211.

Mr. Nebbia agreed that overdue obligations to the Fund remained a matter of concern: they negatively affected the cooperative framework of the institution and the revolving character of its resources, and they could erode the confidence of Fund creditors. Unfortunately, arrears to the Fund had been increasing in amount and in duration. Of course, the amounts remained small in relation to relevant indicators of Fund activity, and few countries were involved. Five of the first ten countries on the list in Table 5 were sub-Saharan countries, all of which were clearly experiencing serious economic difficulties; only one or two countries on the list could be classified as recalcitrant. In general, recent problems in meeting obligations to the Fund had been tied to insufficient progress toward a viable balance of payments position despite repeated adjustment programs and prolonged periods of use of Fund resources that, in turn,

had made obligations to the Fund a major factor in the debt service problems of those countries. Such difficulties made it clear that a number of countries had not yet been able to benefit, at least to the same degree as others, from the current recovery in world trade and economic activity.

The incidence and the amount of overdue payments to the Fund had slightly increased in recent months, but the problem at present did not require fundamental shifts in the Fund's policies and procedures for dealing with arrears, Mr. Nebbia continued. However, he was prepared to consider some of the staff's suggestions for clarifying and strengthening current procedures. First, he could endorse the view that periods relating to consideration by the Executive Board on complaints and notices by the Managing Director should be shortened, so that a decision on the substance of the complaint could be adopted no later than six months after an obligation became overdue. At the same time, like other Directors, he was concerned that governments should be provided with sufficient time to deal with the problem.

The staff had suggested that reviews of programs with members in arrears to the Fund should proceed only after the member became current with the Fund, Mr. Nebbia noted. On that point, he found it difficult to understand why a review of a program could not take place, on the understanding that it would not be put to the Executive Board for consideration until the member became current in its obligations to the Fund.

He could not support the idea of introducing a system of penalty charges for those members unable to discharge their obligations to the Fund on time, Mr. Nebbia remarked. Such members were normally countries facing large external imbalances and having difficulty in meeting their obligations to a number of creditors, including the Fund. A failure to discharge those obligations to the Fund was less a matter of choice than the result of severe economic constraints. To impose additional charges would make it even more difficult for such countries to cope with their obligations.

On the publicity issue, Mr. Nebbia considered, publication of information on members' arrears was unlikely to bring about a solution to the problem and, in certain cases, might only make it worse. He was not prepared to support the proposed modification of the performance criterion on overdue obligations to the Fund, which appeared to be a major policy change that would affect all countries, even though its adoption was being justified on the basis of the actions of only one country. Purchases made under a stand-by arrangement that did not raise the Fund's holdings of a member's currency above 25 percent of quota or, in the case of the special facilities, above 50 percent of quota, were in principle not subject to conditionality; hence, no performance criterion was necessary. To widen the scope of the performance criterion on overdue obligations without regard to the level of the Fund's holdings of the member's currency would be to introduce an unwarranted element of conditionality.

Mr. Pérez remarked that, more than any other financial institution, the Fund should be concerned about a significant increase in payments arrears. Although the magnitudes involved at present probably did not represent a threat to the Fund's financial position, the rapid increase in arrears that had occurred in 1983 and 1984 was certainly worrying, all the more so because those arrears were mostly the reflection of the financial difficulties of member countries, many of which had applied severe adjustment programs aimed at correcting basic disequilibria. It was the Fund's role in promoting international cooperation and in facilitating the correction of payments imbalances among member countries that demanded that its policies for the treatment of arrears be very different from those of other financial institutions.

On the topics suggested by the staff for discussion, Mr. Pérez indicated, first, that he could agree that the period for consideration by the Executive Board of complaints and notices could usefully be shortened. He could also agree that steps should be taken to prevent the possibility of members' being in continuous arrears to the Fund for an indefinite period; at the same time, it would be desirable to extend the proposed period between the Board's initial consideration of a complaint and the taking of substantive action to at least two months in order to give the authorities of the relevant country sufficient time to reply to the complaint and to discuss with the staff the measures being taken to correct the problem.

Another point of interest concerned the review of programs in the context of uniformity of treatment of members, Mr. Pérez continued. The relationship between the Fund and its members rested on the principle of equitable treatment, but it had to be remembered that all countries were not equal and that, particularly with respect to the issues at hand, the factors contributing to indebtedness and arrears were often quite different in nature, ranging from simple technical difficulties to misleading actions. Thus, the Fund should apply the principle of uniformity of treatment by taking into account the nature of those factors underlying the failure to meet obligations. In dealing with a member in arrears, the Fund should take account of the country's specific situation and, far from cutting off lines of communication, must do everything possible to maintain contacts aimed at resolving the problem. Indeed, that idea had been clearly expressed in the Chairman's summing up of the April 5 Board discussion on overdue payments to the Fund (EBM/84/54).

Program reviews could serve to provide members with advice on how to facilitate their efforts to pay overdue obligations, Mr. Pérez commented. Of course, if delays incurred by a member were the result of genuine payments problems--which the program was helping to correct--it was doubtful whether a temporary interruption of a scheduled review would help to speed up payments to the Fund. Similarly, the imposition of penalty charges would probably not constitute an additional incentive for members to become current in their obligations to the Fund; the use of publicity as a tool for encouraging repayment could be counterproductive in certain cases, particularly when the member was making all efforts possible to

adjust. At the same time, publishing information on members' arrears could be prejudicial to the Fund itself. In that respect, his preference was to consider publishing such information only in cases of members that were judged recalcitrant.

Mr. Romuáldez agreed that the issue at hand was basically one of procedure, which by its nature must be general. The particular circumstances of member countries could be focused on at some later stage when the application of those procedures was considered. At that time, the issue of flexibility--a concern mentioned by Mr. Jayawardena--could appropriately be raised.

Since the April 5, 1984 discussion on overdue obligations to the Fund (EBM/84/54), the Board had gained some experience in applying its procedures, Mr. Romuáldez continued. Evidence suggested that the formal actions taken by the Board had not yet led to major improvements in the situation of any of the members subject to those procedures; hence, it was appropriate that the Board should give further thought to tightening or clarifying its procedures. Although the incidence of overdue payments had not become widespread, the problem was confronting an increasing number of members for whom obligations to the Fund had become a major factor in their overall debt and debt service difficulties. The challenges posed to the Fund by the increasing incidence of overdue obligations went beyond the small amounts involved and affected the credibility of the institution and its relationship with its members. In the circumstances, it was important to clarify and explain the procedures for dealing with overdue obligations with a view to assuring members that they would be uniformly treated and to avoid delays in dealing with the obligations, during which time further arrears could accumulate. In that respect, the modifications proposed by the staff seemed reasonable as a way of achieving the Executive Board's aim to keep relatively short the period for initiating formal procedures under Rules K-1 and S-1 while meeting the Board's desire to ensure that members were given sufficient time--up to two months rather than only one--to prepare their reply to a complaint. He could also agree to the recommended procedures for dealing with members experiencing continuous arrears and could support the staff's suggestion for making Executive Board reviews of decisions and complaints a standard feature of the procedures. The three-month period proposed by the staff should be an outside limit, to ensure that members were given an additional incentive to become current. Some circumstances, of course, might well justify a shorter period, which could convey greater urgency. In addition, the renewal of the review period should neither be automatic nor necessarily the same length as the initial review period.

He could support Mr. Polak's views on maintaining contacts with members in arrears, Mr. Romuáldez commented. The section of EBS/84/211 covering contact with members in arrears provided essential clarification of the Board's likely response to a request for rescheduling. Besides making it plain that the burden of proof of justifying rescheduling or

postponement rested with the member concerned, the paper clearly outlined the strict conditions that would have to be met for their rescheduling under the Articles of Agreement.

The case against publishing information on members' overdue obligations remained strong, although the Fund should follow appropriate accounting practices in its financial statements by including, where necessary, some data on members' arrears to the Fund, Mr. Romuáldez considered. Similarly, he was not in favor of imposing penalty charges, which might serve only to exacerbate the balance of payments difficulties underlying some non-technical delays. Indeed, penalty charges might be relevant only in encouraging member countries to focus on problems due to administrative delays. It was not clear that penalty charges would help in dealing with overdue payments that had been outstanding for longer periods. In the circumstances, he questioned the value of a further examination by the staff of the issues and options regarding penalty charges.

He agreed with the staff that it did not yet seem necessary to give consideration to the precise criteria that might trigger or prescribe a declaration of ineligibility to use Fund resources, Mr. Romuáldez remarked. It was sufficient at the present stage to reaffirm that members must realize that, as a case arose, and after other measures appeared to have failed, the Board did not preclude the possibility that it would find it necessary to consider declaring a member ineligible and, if such an action proved unsuccessful in stimulating repayment, to consider other sanctions. Finally, he could endorse the technical amendments proposed by the staff to the decisions approved by the Executive Board at EBM/84/54 in April 1984. Those amendments would have the effect of interrupting a member's right to make purchases under a stand-by or extended arrangement, under the special facilities, or from the first credit tranche outside a stand-by arrangement. In his view, the amendments were necessary to give full effect to the intentions of the Executive Board stated at EBM/84/54.

Mr. Zhang said that, while he preferred not to shorten the periods relating to consideration by the Executive Board of complaints and notices by the Managing Director, he could go along with the staff's suggestion in paragraph 1 on page 19. He had no difficulty with the recommendations put forward in paragraphs 2 and 3. With regard to the suggestions in paragraph 4 on page 20, he did not feel that a review of a program with a member in arrears should be stopped until after the member became current in its obligations to the Fund. The staff's fear that a continuation of mission work under such circumstances would necessarily lead to delays in the application of complaint procedures, or that the results of such a mission would be unproductive, was not justified. On the contrary, it would always be useful for the Fund to maintain a dialogue with the country involved and to offer advice and assistance.

He was not in favor of giving any undue publicity to the payments difficulties of members, Mr. Zhang continued. In particular, data on arrears should not be published in the Annual Report or included in publications of balances of payments statistics. He was also not in

favor of imposing penalty charges on overdue obligations to the Fund. Furthermore, with respect to the staff's suggestion to modify the performance criterion on overdue obligations, he could go along with the suggested wording. However, he was not in favor of the proposal to prevent purchases under special facilities or in the first credit tranche outside stand-by arrangements for a member in arrears, especially since such cases were probably rare. In sum, he could support the staff's move to improve the Fund's procedures of financial management; at the same time, he did not believe that an effort should be made at present to set up stricter preventive measures aimed at anticipating all future situations, especially since it was clear that the problem of overdue payments would not be resolved merely through a tightening of the Fund's procedures for dealing with arrears.

Mr. Goos noted that arrears to the Fund not only represented a non-observance of obligations by member countries but also threatened to impair the financial integrity of the institution. He agreed with the staff that, for the time being, there was no need for fundamental changes in the Fund's approach to overdue financial obligations; however, given the increasing incidence and amounts of overdue payments, a strengthening of the existing procedures would be welcome. He was confident that such a strengthening would help to improve the present unsatisfactory situation; if it did not, however, a more fundamental review of the Fund's approach to arrears would be needed.

Remarking on the specific recommendations on pages 19-20 of EBS/84/211, Mr. Goos agreed, first, that more timely consideration of overdue payments by the Board should have a beneficial impact on the payments habits of some member countries. In that respect, he could strongly support the proposed shortening of the periods between the occurrence of overdue payments and subsequent actions, as well as the proposed extension of procedures on overdue payments to members experiencing continuous arrears. As for the period to be applied in the case of continuous arrears, he agreed with Mr. Zecchini that complaints should be circulated within the same period as that suggested for ordinary overdue payments.

It was clear that more than one approach could be taken to the question of how to deal with program reviews with members in arrears, Mr. Goos continued. However, following the principle of uniform treatment, he was inclined to support the staff's proposal not to proceed with such reviews, an approach that should not, however, prevent the staff from exploring through other channels of communication ways and means of clearing a member's overdue obligations to the Fund.

The recent increase in arrears suggested that the Fund should explore the possibility of introducing penalty charges, and he would therefore welcome a staff paper on the issue, Mr. Goos commented. At the same time, however, it would be premature to establish general criteria for declaring a member ineligible to use the Fund's resources; that matter should be taken up only if the modified procedures on overdue payments failed to produce satisfactory results. In that regard, he agreed with Mr. Nimatallah

and others that the Fund should focus on both remedial and preventive measures for dealing with arrears. He welcomed the steps already taken toward that end by management and staff, as described on page 3 of EBS/84/211, and he encouraged any further strengthening of preventive measures that might be possible. Finally, he would appreciate clarification by the staff on whether the present procedures for dealing with overdue payments--including the proposed modifications--would apply not only to new credit arrangements but also to arrears arising under existing arrangements. In his view, a positive answer to that question would be consistent with the staff's suggestion on page 18 of EBS/84/211 to incorporate into existing credit arrangements a provision that would interrupt a member's right to purchase when overdue obligations to the Fund arose.

Mr. Clark emphasized his authorities' concern about the question of arrears to the Fund and endorsed the concerns expressed by Mr. Nimatallah in his statement. While he could agree that there was no clear case at present for a major review of the Fund's approach to overdue payments, he took little comfort from the figures in the staff paper indicating a rapid and substantial deterioration in late payments. He recognized that a significant part of the problem was attributable to a small number of countries; still, the schedule of repayments to the Fund would become heavier and more widely dispersed over the next year or two, and the risk of late payment could correspondingly increase. On a presentational matter, it might be helpful if, as a regular feature of the six-monthly reviews, the staff could incorporate in an annex a detailed statement of the position of individual countries. In present circumstances, he agreed that some clarification and strengthening of existing procedures on overdue payments was appropriate, within the general policy on arrears previously established by the Board.

As to the specific recommendations for clarifying or strengthening the procedures, Mr. Clark said, he was generally content with the proposals for changes in timing, although he would prefer to see six months regarded as an outside limit for consideration of a complaint by the Executive Board, which might mean initial notification of that complaint in a somewhat shorter period than had been recommended by the staff.

With regard to the treatment of members experiencing continuous arrears, Mr. Clark remarked, he could again go along with the staff proposals, although he was inclined toward making the treatment of continuous arrears and what he would call "normal" arrears as nearly comparable as possible. As Mr. Zecchini had noted, it was easy to imagine patterns of repayment or nonrepayment that would make any distinction between the two types of arrears rather artificial. On Board reviews of decisions on complaints, it seemed essential to reinforce the message that the principal responsibility for action to eliminate arrears lay with the member. In that regard, it might be better to make it clear that, when the Board had considered and accepted a complaint, it would expect prompt action to eliminate the arrears and, if such action were not forthcoming in a reasonable time--say, no more than three months--management would bring to the Board proposals for further action.

He could generally accept the staff's views on the relationship between arrears and review missions, Mr. Clark continued. At the same time, he had concerns similar to those put forward by Mr. Polak. He strongly endorsed the embargo on drawings during a program where arrears had arisen; however, it was possible to imagine circumstances in which delays in conducting discussions with the authorities might not only interrupt a program but also throw it irrevocably off track. Similarly, there might be circumstances in which bridge financing to meet arrears could be forthcoming if there were a firm indication that, on the sole condition that arrears were cleared, the program could continue. Without such assurances--which obviously could not be forthcoming if review discussions had still to be conducted--the offer of bridge financing might fall away. On balance, he would not wish to see any changes in practice that were judged by management to weaken its capacity to bring payments back on schedule; in the circumstances, he would be happy to leave it to management's discretion to decide when, if ever, there might be a case for flexibility on the question of program reviews.

On the publicity issue, he could accept the distinction between what some had called "active" and "passive" publicity, Mr. Clark noted. He was not certain that it would be appropriate or even seemly for the Fund actively to publish information on members' payments difficulties as a way of pressuring those members to repay on time. On the other hand, the Fund was clearly obligated to record, in its published financial statements, information on payments that were overdue. Indeed, because of the Fund's unique status, it should observe conventions at least as stringent as those applying to other commercial and public bodies. As he had indicated earlier, however, he was willing to postpone any decision on the publicity question until after the further discussion of the matter to be held on December 17.

He was of two minds on the possible imposition of penalty charges, Mr. Clark said. On the one hand, it was inappropriate that delayed repayment to the Fund could be regarded as a relatively cheap option; on the other hand, he was uncertain whether, in the particular cases where arrears had arisen, the imposition of penalty charges would greatly add to the Fund's leverage. On balance, he would not wish to rule out the possibility of penalty charges and would be interested in seeing a staff study on the matter before coming to any firm conclusions. Finally, with respect to the scope of the embargo on Fund drawings, he could support all the extensions proposed by the staff in paragraph 7 on page 20 of EBS/84/211. The question of arrears was mainly one that related not to a particular facility but rather to the general relationship between the member and the Fund. Hence, there seemed to be no reason to distinguish between drawings under one heading and those under another. On the aspects of the question not mentioned explicitly in the summary of EBS/84/211--notably ineligibility and rescheduling--he endorsed the practices established after the Board's April discussion. Finally, on what might be called the philosophy behind the issue of overdue payments to the Fund, he tended to agree with the view expressed by the Chairman that there was no question of the Fund's abandoning any of its members;

rather, procedures were being tightened in an effort to ensure that, within the terms of the Articles of Agreement, the Fund was in a position to provide continuing support to its members.

Mr. Salehkhrou observed that his chair had always attached importance to the financial integrity of the Fund and the revolving character of its resources, both of which required prompt repayment of resources borrowed from the institution. Any lack of progress thus far in limiting the amount of members' overdue obligations to the Fund had to be understood as mainly due not to the hitherto lax debt collection procedures adopted by the Fund but rather to an overall deterioration in the global economic situation experienced by members in the past few years that had undermined the solvency of many countries and their ability to service their financial obligations to all creditors, including the Fund and the World Bank. Indeed, overdue obligations to the Fund had risen from SDR 2.7 million in March 1981 to SDR 35.6 million at end-1983, rescheduled total external arrears of debtor nations had risen from \$15 billion in 1982 to \$60 billion by the end of 1983.

According to Table 1 of EBS/84/211, great variations existed in the total amount of outstanding overdue obligations to the Fund, which denoted the utmost efforts by the affected members to honor their obligations to the best of their ability, Mr. Salehkhrou continued. In fact, only in 1984 had total arrears to the Fund shown a persistent rise from one quarter to the next; in the previous three years, arrears to the Fund had often declined from quarter to quarter, suggesting the seriousness with which debtor countries viewed their arrears to the Fund. However, with regard to the number of countries affected vis-à-vis total amounts, variations had persisted well into 1984. The seasonal variations of the trend in the amounts of overdue obligations to the Fund did not correspond to variations in the number of countries likewise affected. Hence, according to Table 1, the second and fourth quarters of each of the past four years had shown unusual bunching in the number of countries with Fund arrears, although no similar or even other pattern could be discerned with respect to the amount of overdue obligations. An explanation of those differences was in order.

Any justification for adopting a tougher approach to defaulting members should be based, in the absence of analyses about the origin and causes of the problem, on the possible benefits and costs of such an approach, Mr. Salehkhrou noted. If it was accepted that arrears had not been deliberate or preconceived, it was questionable whether harsher measures would necessarily produce positive results. He wondered how many members in arrears had sufficient foreign exchange reserves to repay any creditor, let alone the Fund. He was also interested in the costs of the tougher measures being proposed. Another point to ponder was that, while other creditors had accepted rescheduling terms with debtors, thus giving borrowers a necessary, albeit transient, respite, the Fund had understandably not been able to follow suit, which seemed to give its loans an aura of financial rigidity.

For many countries, the Fund had become a major creditor and provider of loans, and the regular and timely servicing of those loans had become an increasing burden for some smaller borrowers, given the global economic plight of the past few years, Mr. Salehkhoh remarked. In that context, a doubling or tripling of the amount of overdue payments should not cause unreasonable alarm. Any ad hoc approach that did not address the underlying causes of the emerging liquidity problems of debtor nations could be temporary and self-defeating.

Table 5 on page 26 of the staff report showed the duration and frequency of overdue payments of individual members, Mr. Salehkhoh observed. The presentation of that table, as it stood, lumped all countries together: those with more temporary or transient overdue payments that could more conveniently be termed "late payers" and those more permanent and serious cases. It could not be ascertained from the table which of the countries listed had continued with nonpayment and which had rectified their position; and, in that sense, the table required further clarification. More than half the countries listed had been in arrears for an average of only four weeks or less, and most of those were low-income developing countries. For many of them, according to World Bank estimates, gross international reserves in terms of months of import coverage had reached a critically low level.

He had been puzzled by the staff's assertion on page 3 of EBS/84/211 that the plight of members in arrears to the Fund had been due in part to economic mismanagement, which had begun well before the emergence of the global recession and had been accompanied by a lack of progress toward adjustment, despite prolonged use of Fund resources, Mr. Salehkhoh commented. Most of the low-income countries mentioned had been harshly affected by the external factors, including drought, falling commodity prices, protectionism in industrial countries, and rising interest rates. Some of those factors--such as the drought in Africa--were recurrent and had made their mark well before the recessionary cycle had begun. Most of the countries in arrears had also been completely shut out of access to capital markets because of regionalization that had emerged during the debt crisis. In that respect, the staff's explanations did not address the real issues and complexities of the arrears situation. Moreover, he was unable to find any explanation by the staff of the situation of those defaulting members that had regularly had in place Fund-supported adjustment programs and had continuously met or even surpassed all performance criteria yet remained far from achieving economic viability. Perhaps it was the effectiveness of the adjustment programs themselves that was deserving of criticism.

Turning to the procedural modifications outlined on pages 19-20 of EBS/84/211, Mr. Salehkhoh said, first, that a shortening of the duration of the Executive Board's consideration of a complaint to less than six months was unwarranted. He could not share the view of the staff expressed on page 5 that "the present timing may simply permit larger and less tractable difficulties to develop before the Board becomes directly engaged." Countries with Fund arrears, because they were generally

excluded from access to capital markets, should be provided with as much time as possible to explore avenues of appropriate financing. Indeed, in view of the present difficulties experienced by such countries, they should be accorded the benefit of any doubt. In that respect, he could support the present timing procedures.

It was unlikely that there would be any widespread incidence of members experiencing continuous arrears, Mr. Salehkhon considered. As the staff had noted, the elimination of some arrears was indicative of the serious efforts made by some members to reduce and eliminate their overdue obligations to the Fund. Thus far, only one member country found itself in the category of those experiencing continuous arrears. It was ironic that, in relation to borrowing, the revolving character of the Fund's resources was considered in a positive light, while, in relation to arrears, the tendency was to overreact in a negative way when the possibility of "revolving arrears" was considered. It was clear that there had never been established any deliberate attempt by debtors to accumulate Fund arrears, let alone on a revolving basis; indeed, many small debtor nations had been victims of financial and economic circumstances of the sort that demanded flexibility and discretion on the part of the Fund in dealing with them.

He could agree that, pending the existence of exceptional or mitigating circumstances, reviews of programs with members in arrears to the Fund should proceed only after the member became current in its obligations, Mr. Salehkhon commented. In those circumstances, discussions involving the use of Fund resources should be confined to the normal Article IV consultations, which could provide the staff with an opportunity accurately to assess the ability of the defaulting member to generate sufficient earnings to repay its creditors. Of course, such consultations should not address only the issue of a member's indebtedness to the Fund; rather, it should consider the full range of counteracting forces that had led to the default and should aim at finding ways of resolving the member's problems. In that respect, it should be taken for granted that the member in default already appreciated the seriousness of its arrears to the Fund, an institution that had probably been approached by the member as a last resort. If that were understood, then the purpose of the staff's contacts with the member would be seen as conciliatory and constructive rather than prohibitive and punitive.

He was reluctant to go along with the staff's suggestion that data on members' arrears to the Fund should be reflected in relevant reports released to the public once the duration of the arrears exceeded six months, Mr. Salehkhon said. Such an approach should be reserved for use in exceptional cases of bad faith or deliberate nonpayment in the face of the availability of financial means. It was not worth imposing such approach on the grounds that the publication of information would adversely affect the creditworthiness of the member; by the time a member defaulted on any Fund loan, it was probably already in serious financial difficulty with other creditors. A better case could be made on the basis of the principle of confidentiality.

With regard to the imposition of penalty charges and declarations of ineligibility, the staff had rightly refrained from venturing into uncharted territory, Mr. Salehkhrou noted. Any specific criteria laid down in anticipation of an uncertain future could prove self-defeating.

He could go along with the staff's proposal to close the technical loophole created in establishing the performance criterion on the avoidance of overdue obligations, Mr. Salehkhrou observed. However, he could not go along with the suggestion to extend the modified procedure to the first credit tranche drawings outside the Fund's adjustment programs or to the special facilities. The special facilities had an "emergency" character about them and were designed to alleviate economic hardships brought about by exogenous factors, while first credit tranche drawings outside the framework of adjustment programs were unrelated to the principle that no purchases resulting in the use of Fund credit under a stand-by arrangement should be made while a member was in arrears to the Fund.

On more general matters, Mr. Salehkhrou considered, creditor countries with windfall surplus funds should be reminded that, beyond their pecuniary interests in enhancing the Fund's debt-collecting machinery, they should focus more closely on the cooperative nature of the institution. Naturally, the international capital markets were the usual outlets, providing such creditors with high-yield investment opportunities; the Fund should not be confused with those commercial outlets, the principal aim of which was to maximize profits. Such creditors should also be reminded that the voting power structure in the Fund, at least as far as Third World countries were concerned, was already unsatisfactory; any move that would further incline the decision-making process of the institution to the detriment of debtor members--which also happened to be mainly low-income countries--should be avoided.

In that connection, he was specifically referring to those defaulting members whose authorities' sincere and painstaking efforts in meeting their overdue financial obligations had been confidently established by the staff, Mr. Salehkhrou concluded. At the present time of economic uncertainty and universal lack of understanding, such creditors would be advised to observe the following advice from the Quran, which should be indicative of the prevailing attitude in the Islamic world--comprising a third of Fund member countries, a good number of which were heavily indebted--and certainly shared by many other LDCs: "...deal not unjustly and ye shall not be dealt with unjustly; if the debtor is in a difficulty, grant him time, till it is easy for him to repay...." On a related matter, he observed that the list of nonpaying countries should not end with developing countries; there were industrial countries with default records, if not to the Fund at least to other nations. Their manipulation of the existing self-imposed laws and technical regulations were such that they could conveniently evade prompt payment without generating adverse publicity. Finally, he looked forward to the December 17 discussion of the effect on income and the treatment in financial statements of overdue obligations with the Fund.

The Executive Directors agreed to continue their discussion in the afternoon.

DECISION TAKEN SINCE PREVIOUS BOARD MEETING

The following decision was adopted by the Executive Board without meeting in the period between EBM/84/165 (11/16/84) and EBM/84/166 (11/19/84).

3. EXECUTIVE BOARD TRAVEL

Travel by Executive Directors as set forth in EBAP/84/245 (11/15/84) is approved.

APPROVED: August 21, 1985

JOSEPH W. LANG, JR.  
Acting Secretary

