

INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 84/167

3:00 p.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
H. C. Schneider
X. Blandin

J. E. Ismael

T. Yamashita
B. Goos

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

L. Leonard
H. A. Arias, Temporary
A. S. Jayawardena
E. A. Ajayi
B. Jensen
J. E. Suraisry

G. Salehkhoul
J. Tvedt

A. V. Romuáldez

S. Zecchini
Zhang Z.

T. A. Clark
N. Coumbis
Wang E.

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

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Also Present

Exchange and Trade Relations Department: M. Guitián, Deputy Director; P. J. Quirk. Legal Department: G. P. Nicoletopoulos, Director; W. E. Holder, Ph. Lachman, A. O. Liuksila, S. A. Silard. Middle Eastern Department: S. Geadah. 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., D. Gupta, S. I. Fawzi, 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, G. Castellanos, D. Hammann, G. E. L. Nguyen, J.-C. Obame, P. Péterfalvy, G. W. K. Pickering, T. Sirivedhin, D. C. Templeman, A. Vasudevan. Assistants to Executive Directors: E. M. Ainley, J. Bulloch, M. B. Chatah, L. E. J. M. Coene, J. de la Herrán, C. Flamant, G. D. Hodgson, A. K. Juusela, M. Lundsager, R. Msadek, K. Murakami, T. Ramtoolah, M. Rasyid, J. Reddy, A. A. Scholten, S. Sornyanontr, L. Tornetta, A. J. Tregilgas, E. L. Walker, A. Yasseri.

1. OVERDUE FINANCIAL OBLIGATIONS - SIX MONTHLY REPORT

The Executive Directors continued from the previous meeting (EBM/84/166, 11/19/84) their consideration of 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. Arias stated that he shared the concerns of the staff and his colleagues on the problem of overdue financial obligations to the Fund. However, as the staff had noted, arrears to the Fund were not widespread, and it was not clear from the tables in EBS/84/211, Supplement 1 that the Fund would face a financial burden in the near future because of those arrears. Besides, in the past, some overdue payments had been related to technical and administrative problems.

It was remarkable that, throughout the current international crisis, overdue financial obligations to the Fund had not been greater and more widespread, Mr. Arias continued. It must be recalled that overdue payments to the Fund arose as a consequence of several factors, most of which were beyond the control of individual member countries; more precisely, they were part of the international financial crisis. While it was clear that the Fund must safeguard its financial integrity and the revolving and temporary character of its resources, that did not necessarily mean that it should consider abandoning a flexible, case-by-case approach to the problem of arrears. It was in that context that he approached the specific topics for discussion on pages 19-20 of EBS/84/211.

He was in favor of extending the period for consideration by the Executive Board of complaints and notices by the Managing Director, Mr. Arias commented. He could also accept the proposed flexibility around a three-month limit for Board reviews of decisions on complaints. He was, however, strongly opposed to the suggestions in paragraphs 4-6 on page 20. Finally, with regard to the proposed modifications of the performance criterion on overdue payments to the Fund, he could support the clarification that no purchases in the upper credit tranches should be made while a member was in arrears to the Fund; however, he could not agree to the extension of the modification to the special facilities.

Ms. Bush remarked that the position of the United States on arrears to the Fund rested largely on the maintenance of three requirements: the credibility and financial soundness of the Fund; the revolving character of the institution's resources; and the uniformity of treatment for all members with regard to their financial obligations to the Fund. It was disturbing to note that arrears to the Fund had grown from SDR 46 million some six months previously to SDR 113 million at present. During the period, some members had become current in their overdue obligations to the Fund; others had not. In that context, the aim should be to refine the guidelines for dealing with arrears in such a way as to make them

more effective. Like Mr. Nimatallah, she saw the need for a two-pronged approach to the problem of arrears that would focus on ways of avoiding overdue financial obligations in the first place and on dealing more effectively with the problem of arrears already in existence.

With regard to the recommendations on pages 19-20 of EBS/84/211, Ms. Bush said, she could support the proposal to shorten the periods relating to consideration by the Executive Board of complaints and notices by the Managing Director. She could also agree that the same timing guidelines should be applied to those members experiencing continuous arrears.

The procedures that the Executive Board had established in April 1984 for dealing with arrears did not specify a mandatory review period, Ms. Bush recalled. However, there had been at least three cases in which the Board had considered a complaint on substance, had adopted a decision, and had set a time to review that decision. In two of those cases, the Board had reviewed the decision, renewed the review period, and called for a second review. While, in principle, the Executive Board should certainly review its decisions, particularly in the light of a member's efforts to settle its arrears, it was debatable whether a review period should be set automatically as part of the procedures, since such an approach might give the impression that an automatic grace period was being given to the member. All members should understand that they were expected to eliminate arrears forthwith, whatever review period might be established.

She could support the recommendation that program reviews should not be completed while a member was in arrears to the Fund, Ms. Bush continued. However, such an interruption should not delay needed corrective economic policy action or the formulation of concrete plans for repaying the Fund. In that respect, Article IV consultations, technical assistance missions and other special missions should be continued if they were considered useful in assisting members to devise plans for prompt payment of past due obligations. In some cases, for example, special staff missions might be able closely to monitor the priority that a member country was assigning to repaying the Fund vis-à-vis other creditors; and there might even be occasions where a special mission could examine in some detail the sources and uses of foreign exchange in order to make a judgment about the country's ability to repay.

With regard to the possibility of penalty charges, Ms. Bush recalled that, during the Board's April discussion on overdue financial obligations (EBM/84/54), her chair had supported exploration of the idea of a penalty charge at some market-related interest rate. Perhaps the staff should begin to analyze how penalty charges could be used, for example, as a deterrent to arrears, as a method of recouping the cost to other members that were incurred when some members were in arrears, and as an incentive to ensure that top priority was given to repaying the Fund. On a related matter, she remarked that postponement or rescheduling of overdue obligations was not an appropriate answer to the problem of arrears.

The publication of information on members' arrears could be a useful mechanism for reminding members of the gravity of the arrears problem, Ms. Bush considered. It would seem appropriate to incorporate such information in the publications mentioned by the staff, although she understood that the Board would have a further opportunity on December 17 to comment on that matter.

She could support a modification of the performance criterion on overdue obligations to the Fund that would clarify that any drawings under a stand-by arrangement--without regard to the level of the Fund's holdings of a member's currency--and any drawings under the special facilities or first credit tranche purchases outside of stand-by arrangements should not be made while a member was in arrears, Ms. Bush commented. Such a clarification would ensure that all cases conformed to the intention of the Board that drawings should not occur while overdue obligations were outstanding.

Noting that the Board needed to examine how the Fund could better anticipate problems with arrears, Ms. Bush agreed with Mr. Nimatallah that the medium-term debt scenario would be a good mechanism for focusing more on the size and timing of overall obligations to the Fund and on the overall debt maturity schedule of the members involved. On the justification for the proposed modifications, she observed that the Fund was in a unique situation in that its debtors were also its members and that the institution relied on mutual trust and cooperation. Everyone was cognizant of the hardships having faced many Fund members during the past few years, and the Fund had worked hard in order to help its members cope with those problems. A country's membership in the institution carried with it the responsibility to other members to live up to its obligations under the Articles of Agreement; it was neither fair nor workable to have some members fulfilling their responsibilities with others failing to do so. For those reasons, the problem of overdue payments must be dealt with very strictly lest it threaten the monetary and revolving character of the Fund and its ability to function properly to provide financial support to countries with balance of payments problems. It was thus in the interest of all members to put in place procedures that would prevent the problem of overdue payments from growing, continuing, or even arising in the first place.

Mr. Blandin remarked that the recent increase in arrears was grounds for serious concern and, in that respect, he could associate himself with the remarks of Mr. Zecchini at EBM/84/166. On the one hand, it was important to indicate that the Fund would not tolerate arrears; at the same time, the institution must be sufficiently flexible so as to avoid a situation in which it was unable to recover repayments owed it.

For the reasons that he had mentioned, and because the existing procedure had proven successful in some cases, he was not in favor of shortening the periods relating to consideration by the Executive Board of complaints and notices by the Managing Director, Mr. Blandin continued.

The present limit of five months seemed both appropriate and realistic, although it should be viewed as an outside limit; in any case, the Board's examination of and decision on the substance of a complaint should occur within six months after an obligation became overdue. He could go along with the other staff recommendations contained in paragraph 1 on page 19. A period of one month should normally be allowed between the Board's initial consideration and its substantive disposition of the matter; and the Board could decide whether to provide up to two months according to the circumstances. He could also agree that reports to the Board on the emergence of overdue financial obligations could be made one month rather than six weeks after an obligation had become overdue.

His authorities felt that the matter of continuous arrears to the Fund should be carefully reviewed and perhaps linked to the discussions scheduled for December 17, Mr. Blandin noted. In that respect, they would not wish to take a firm position on the matter of continuous arrears at the present meeting, although they tended toward the recommendations of the staff.

He agreed that Executive Board reviews of its decisions on complaints could usefully become a standard feature of the procedures for dealing with overdue obligations to the Fund, Mr. Blandin continued. However, the reviews should not be considered grace periods, and the agreed procedure should not discourage members from discharging their obligations as soon as possible.

The recommendation that reviews of programs with members in arrears to the Fund should proceed only after the member became current with the Fund gave him pause, Mr. Blandin commented. Adopting too tough a position could reduce the chances of putting a program back on track; he agreed that members should not draw until they were current in their obligations, but a dialogue between the member and the Fund should be pursued in some form even when the member was in arrears. The dialogue could perhaps take the form of ad hoc missions directed to review the general situation of the member and to seek ways and means of resolving the arrears problem.

On the final three paragraphs on page 20, Mr. Blandin remarked that the issue of publicity could usefully be discussed during the December 17 meeting on the relationship between arrears and the financial position of the Fund; however, his authorities at present tended toward the view that the difficulties between the Fund and members in arrears generally received sufficient de facto publicity already. As for paragraph 6, his authorities were reluctant to take a position on the question of penalty charges, although they were willing to look at a staff study on the subject. Finally, he could go along with the staff proposals relating to the modification of the performance criterion under stand-by arrangements.

Mr. Tshishimbi recalled that, during the April discussion on overdue financial obligations to the Fund, his chair had expressed concern over the growing arrears problem. Unfortunately, developments since that time

had not served to alleviate that concern; indeed, the amounts of arrears to the Fund had more than tripled since April 1984. Still, the problem remained within manageable limits, and he was please to note the staff's indication that the incidence of overdue payments to the Fund had not become widespread.

In the past four months, his chair had experienced at first hand the problem of payments delays to the Fund, a problem that had been resolved only recently, Mr. Tshishimbi continued. The flexible approach adopted by the Fund in the case in question had strengthened his view that the problem of overdue payments was not at present out of hand. It had also strengthened his belief that it was important to preserve flexibility for staff and management in dealing with members in arrears. He agreed with those who felt that real problems might still lay ahead, given the uncertainties that continued to prevail in the world economy; and it was in that sense that he understood Mr. Jayawardena's earlier plea for examining more closely the cases of low-quota and low-income countries in arrears to the Fund. He had not understood Mr. Jayawardena to be asking for preferential treatment for those countries but only for a clearer understanding of their situation.

Remarking on the recommendations on pages 19-20 of EBS/84/211, Mr. Tshishimbi said that he had no difficulty with the suggestions contained in the first three paragraphs, although he was a bit concerned that one month might not be enough time between the initial consideration of a complaint by the Board and its substantive discussion of the matter. Allowing more time could be helpful to the member in preparing an appropriate response to the complaint. Recent experience with respect to member countries in his constituency suggested that a two-month period would be preferable in some circumstances.

Like some others who had remarked on the recommendations in paragraph 4, he believed that outstanding payments arrears should not prevent the review of ongoing programs with members, Mr. Tshishimbi went on. Countries with successful programs should be able to resort to bridge financing in order to settle their arrears to the Fund and, if that approach were accepted, it should be possible to extend it to cases in which members had successfully completed a shadow program with the Fund and had been on the verge of entering into arrangements for a formal program when payments arrears had occurred.

Noting the agreement of others to reserve comment on the publicity question until the December 17 Board meeting, Mr. Tshishimbi said that he contined to feel that it would be inappropriate to give publicity of any sort to information on individual members' overdue payments to the Fund. Such an approach could seriously erode the trust that had always characterized relations between the Fund and its members.

On the matter of penalty charges, Mr. Tshishimbi observed that member countries did not intentionally go into arrears to the Fund; rather, overdue payments obligations arose because of technical problems

or misunderstandings or because of genuine difficulties, such as natural disasters, over which the authorities had no control. As his chair had stated on several occasions, the imposition of a penalty charge would only exacerbate the payments difficulties of members. It was clear that, particularly in the case of members that were recalcitrant in meeting their obligations to the Fund, additional steps should be taken, but a penalty charge would not be especially helpful.

He was not at all in favor of the proposal in paragraph 7, which seemed to have been designed to deal with hypothetical situations rather than real ones, Mr. Tshishimbi commented. Finally, he was troubled by the following sentence about possible postponements or reschedulings of Fund obligations on page 13 of EBS/84/211:

The present approach does not preclude postponement on a case-by-case basis but makes it clear that the burden of showing exceptional hardship is on the member and that a positive response to a request of such a nature is unlikely to be forthcoming.

Was the staff suggesting that it was unlikely that a case would ever arise that would justify either a postponement or a rescheduling of the overdue obligations, even though the Articles of Agreement provided for such an approach?

Mr. Finaish stated that he too was concerned about the upward trend in overdue payments to the Fund. Although the incidence and amounts of overdue obligations remained small, he attached importance to reversing the upward trend, particularly in cases of protracted delays, which could be quite detrimental to the countries concerned and to the membership as a whole. He continued to believe that, in setting procedures to deal with individual cases of arrears when they occurred, due regard should be given to the retention of flexibility within the context of the principle of uniform treatment of members in order to enable the Fund to deal appropriately with the diversity of circumstances of countries experiencing overdue obligations.

The procedural steps to be followed when countries became overdue in their obligations represented only one aspect of the task at hand, Mr. Finaish continued. It would also be useful to consider taking a broader look at the root causes of the problem, perhaps in the context of the next review, particularly in light of the fact that the list of countries overdue in their obligations to the Fund showed a concentration of small, low-income countries with little or no access to capital markets or commercial bank lending. In the light of those considerations, he believed that the procedures agreed in April 1984 remained generally appropriate and that no major change in them was needed at present.

While he had no difficulty with the suggestion for shortening the periods between the time the Executive Board was first informed of an overdue obligation and the date of the Board's substantive disposition of

the matter, he was unsure that it was desirable to change or "fine-tune" that aspect of the procedures without a clear need to do so, Mr. Finaish said. On balance, he favored maintaining the present periods. As for the procedures for dealing with members experiencing continuous overdue obligations without any individual payment remaining outstanding for an extended period, he could go along with the suggestion to circulate a complaint to the Board within a somewhat longer period. As the staff had noted, the elimination of some arrears to the Fund could be taken as evidence of the member's efforts to fulfill its obligations. He could also go along with the suggestion to make Board reviews of decisions on complaints a standard feature of the procedures and could accept the three-month norm proposed by the staff. However, the Board should retain flexibility to extend or shorten that period, depending on individual circumstances.

The principle of uniform treatment implied that program reviews with members in arrears to the Fund, like new programs, should not be concluded while the country was overdue in its obligations, Mr. Finaish remarked. The same principle suggested that, since discussions of new programs entailed consideration of the adjustment measures that would make it possible for the member to repay--and could possibly be supported later by a program--similar discussions should not be excluded in cases involving reviews of existing programs.

He continued to believe that deliberate "active" publicity of information on the overdue obligations of members should be avoided, Mr. Finaish commented. Any possible positive effect of such publicity might be more than offset by a negative preception of the Fund either as insensitive to the legitimate difficulties of members or as an institution that was using its catalytic role to compound those difficulties. At the same time, the Fund should not jeopardize the integrity or standards of its financial reports by failing to incorporate required information. He would reserve further comment on that matter until it was discussed in the December 17 Board meeting on the treatment of arrears in the Fund's financial statements.

Like others, he continued to have reservations about the usefulness of imposing penalty charges on members in arrears to the Fund, Mr. Finaish said. Finally, he had mixed feelings about the suggestion to prevent purchases in the first credit tranche or under the special facilities while a member was in arrears to the Fund. On the one hand, the special nature of such purchases argued against the staff's proposal; at the same time, consistency suggested that no purchases from the Fund should be possible while a member was overdue in its obligations to the Fund. On balance, he could go along with the staff's recommendation.

Mr. Jayawardena observed, first, that he had been unable to find in the staff papers any analysis showing that the increase in overdue obligations was due to any weakness or inadequacy of the current procedures or deterrents against defaults by members. Hence, he wondered whether it had clearly been determined that the current flexible approach was inadequate

and insufficient. Second, he would appreciate hearing the staff's diagnosis of factors responsible for the increase in overdue obligations. If the increase had resulted from a backlash of the recent recession on most economically vulnerable countries, would not the expected economic recovery reduce the scope of the problem in future, thus making the recommended tightening of procedures unwarranted? If the recovery were unlikely to help, and if those countries had serious structural problems, he wondered why the staff was not recommending that the Fund should come up with more comprehensive programs, in collaboration with other institutions, to help those countries. Third, it was unclear whether, in making proposals for tightening procedures, the staff had come to the conclusion that the additional practices and procedures would help to reduce overdue obligations; if so, he would appreciate some elaboration on how they would help. If the staff felt that the arrears had grown because of recalcitrance on the part of a few countries, then the proposed tightening of the procedures might be justified; yet it was evident that recalcitrance had been observed in only a handful of countries, which suggested that the Fund might better tackle the problem flexibly, using a case-by-case approach.

The Treasurer recalled the concern of a number of Directors that the proposed shortening of periods relating to consideration by the Executive Board of complaints and notices by the Managing Director might not leave sufficient time for the member concerned to take the appropriate steps to eliminate its arrears. On the basis of experience, the staff felt that the periods proposed would leave members with adequate time. Most of those arrears not related to more deep-seated problems were caused by inadequate domestic procedures, temporary shortages of reserves, and general administrative weaknesses; overdue financial obligations arising from those difficulties were normally cleared in two to three weeks. Besides, the problem of collecting arrears did not begin on the day in which the obligation became overdue: members knew well in advance of the due date by which they would have to arrange for sufficient funds to meet their scheduled obligations. Of course, unexpected events could unfold, but he knew of no case so far in which a member's inability to fulfill its obligation on the due date had been caused by a large and unexpected external event.

In response to those concerned about the effectiveness of the proposed timing changes, the Treasurer considered that a shortening of the periods would in fact help to reduce the total amount of arrears or avoid any further increase. Using the case of Chad as an example, he noted that it had been clear from the beginning that certain actions would have to be taken to procure local currency in order for Chad to be able to buy foreign exchange from its common central bank, the Bank of Central African States. If the procedures had called for the Executive Board to indicate the strength of its view on the matter at an earlier date, the repayment might well have been speeded up. In general, action was frequently delayed until the time of a deadline. In that respect, the staff believed that a shortening of the periods would be helpful in the effort to eliminate arrears to the Fund.

Observing that no conclusions had yet been reached on the question of publicity, the Treasurer remarked that the staff did not place great store in the hope that publication of information on members' arrears would improve the effectiveness of the collection effort, although the threat of publicity could be useful in certain cases and should therefore not be precluded. Mr. Clark had inquired whether publicity of the more "passive" sort that was required by good accounting principles would not reflect adversely on the Fund. While it was clear that any indication of the existence of arrears would show that the Fund was experiencing some difficulty, Directors should consider the effect on the Fund's reputation if it failed to publish any information on arrears and were thus perceived to be covering up the facts of its financial position. Without taking a position on the matter, he would say in response to those who had questioned the effectiveness of publicity that it could be used as an instrument to maintain the Fund's integrity and reputation as a cooperative public institution.

It was unfortunate that the staff's recommendation to interrupt or avoid program reviews with members in arrears to the Fund had been understood as a recommendation that the Fund should cut off all communications with members in arrears, the Treasurer stated. It must be remembered that staff and management were in continuous contact with members in arrears; indeed, some members were uneasy about the Fund's frequent attempts to communicate with them on the specific stance that they should be taking to eliminate their arrears to the Fund. The staff had proposed, and the Executive Board had approved, a number of special missions to such countries, and every effort was being made to maintain a positive dialogue. What the staff was now proposing was that formal program reviews designed to examine existing performance criteria or establish new ones should be postponed until the member was no longer in arrears to the Fund. Of course, one could be of two minds on the issue, and the problem was where to strike the balance. Hypothetically, at least, a member in arrears could engage in lengthy review discussions in the knowledge that those discussions would lead to an involuntary prolongation of the arrears while the review discussions were going on. It was for that reason that the staff had made its recommendation.

During its April discussion on overdue obligations to the Fund (EBS/84/54), the Executive Board had reaffirmed the principle that a member in arrears should not receive any additional credit from the Fund, the Treasurer recalled. The performance criterion proposed to the Board in April had been designed to build that principle into the legal constructs of Fund stand-by and extended arrangements. Previously, if a member had fulfilled all performance criteria under an extended arrangement, it would have been difficult for the Fund to hold up any purchases under the arrangement, despite the general principle that no purchases should be made by members in arrears. The Executive Directors had thus endorsed and approved an amendment of the form of stand-by and extended arrangements so as to make it clear that members would not be permitted to draw--even if all economic conditions were met--so long as they were in arrears. At

present, Directors were dealing with a subitem of that issue aimed at closing a potential loophole whereby the interrupting of a purchase might not apply to the first credit tranche under a stand-by arrangement. The staff was also proposing to apply the principle to the special facilities and to first credit tranche purchases made outside stand-by arrangements in order to deal with a difference between those purchases and purchases under stand-by and extended arrangements. With the former, once a decision was adopted by the Board, the money was paid out immediately. If there were arrears outstanding, the Board would simply not adopt a decision agreeing to the stand-by or extended arrangement. In compensatory financing facility purchases or first credit tranche purchases outside stand-by arrangements, however, there was a delay of a few days between the date of Executive Board agreement to the purchase and the value date; there was no protection for the Fund if arrears arose during that period. No case of that sort had yet occurred. However, cases frequently arose in which repurchases came due during that period, so the hypothetical case represented a real possibility.

The modification being proposed should not be viewed as a performance clause that would increase conditionality, the Treasurer continued. What was intended was a provision that would ensure that no members in arrears would use additional Fund credit unless and until the Executive Board took a decision allowing them to do so. He hoped that the point would answer Mr. Zecchini's question about whether or not the Executive Board could make exceptions to its policy; the Board could at any time decide to waive the provision as a matter of policy.

In response to a question from Mr. Goos, the Treasurer noted that the proposed extension of the principle in question would be introduced after the Board had formally adopted it. A separate formal proposal in proper legal language would then need to be accepted for introduction into all new arrangements or those up for revision. There would be no retroactive application of the extended principle; it would, however, be incorporated into existing arrangements whenever a decision was required with respect to such arrangements.

Comparable data on arrears in other institutions were not readily available, although an effort could be made to provide such information in the next six-monthly report, the Treasurer said. Whatever such information might show, however, he would continue to feel that it was not necessarily relevant to the problem of arrears in the Fund, which functioned in a special way in the international monetary system. One of the conclusions drawn by the Executive Board at its April 1984 discussion was that the Fund should not be viewed in the same way as other creditors.

In noting the provision of the Articles that allowed the Fund, under certain rather strict conditions, to grant a postponement of a member's arrears, Mr. Tshishimbi had asked for an assessment by the staff of whether such a postponement was ever likely to be granted, the Treasurer recalled. On the basis of the Fund's present policy and the staff's

reading of the Articles of Agreement, it would be a rare instance indeed if a case meriting a postponement were to arise. If a case could be made, the staff would of course have no hesitation about bringing it forward for approval; however, in the two instances in which the staff had brought forward recommendations for postponement in the past, those recommendations had turned out to be "wrong" in the sense that the postponement had not contributed to resolving the problems of the countries concerned. Both members were still in arrears to the Fund at present. Against that background, the staff would want to look very closely at the circumstances of the member before recommending a postponement, as allowed under the Articles.

In response to questions concerning the factors responsible for delays in repayment, the Treasurer noted that he had already drawn a distinction between administrative delays and those of a more fundamental nature that were related to the member's economic and balance of payments positions. Each case was examined in detail by the concerned Fund departments in order to determine the causes of the arrears. In the past, there had been cases in which the delay in repayment had been caused by a lack of foreign exchange of the sort experienced by Chad; in other cases, external demand for a country's exports had diminished; sometimes the world economic situation had made it difficult for the country to service its debt; at other times, the member's own policies had been inadequate; and, occasionally, development aid had turned out to be insufficient for the total financing of the country. He had taken note of the interest of Directors in the types of problems giving rise to arrears to the Fund. A description of a member's situation was normally included in the documentation relating to a complaint; in some cases, much more extensive analysis was available to Directors in the form of a recent consultation report.

To those who had expressed an interest in hearing how the World Bank dealt with its arrears, the Treasurer observed that a meeting between the institutions had recently been arranged to clarify precisely those questions. As he understood it, the World Bank had established clear procedures that were similar to those of the Fund, albeit with somewhat different timing. When an overdue payment arose, the Bank did all that it could to clarify the situation through further communication with the member. When a payment became 30 days overdue, the Executive Board was informed; after two months, a warning was issued to the country that all disbursements would be cut off unless the arrears were eliminated. In effect, after less than three months, no further disbursements were made on any loan to a country in arrears. What followed thereafter was not fully clear, although he understood that the World Bank did on occasion send special missions aimed at persuading the member to rearrange its affairs and to give priority to the Bank in meeting its obligations.

The overall amounts of arrears in the World Bank at present were smaller than those in the Fund, the Treasurer observed. However, that information would not be particularly meaningful unless it were compared with the total amounts of loans outstanding and payments due, comparisons

that he was unable to make at present. He understood that arrears had increased during 1984 and, in general, had followed a pattern similar to that experienced in the Fund, albeit on a somewhat smaller scale. Finally, the lists of countries in arrears to the two institutions were not identical. If Directors so wished, more information on arrears in the World Bank could be included in the next six-monthly report to the Board, although he was not certain that the experience of the IBRD in relation to that of the Fund would necessarily be useful in formulating Fund policy.

The Deputy Director of the Exchange and Trade Relations Department, commenting on the suggestion made by several speakers that both preventive and curative measures should be found for dealing with the problem of arrears, remarked that the staff had been looking closely at members' medium-term positions and, in particular, at the proportion of debt payments due to the Fund as important elements in working out new arrangements with members.

Mr. Polak said that he was curious about how the staff intended to implement its proposal to ensure that purchases would not be made under the special facilities even if a member fell into arrears in the four days between the time when the request was approved and the time when the amount was actually drawn. Was the intention to incorporate a clause in each decision approving purchases under the special facilities indicating that the drawing would be conditional on the member's not being in arrears?

On another matter, Mr. Polak said that he would be grateful if, in its next report, the staff provided somewhat more information on arrears in the World Bank. In that connection, observing that the Bank cut off disbursements to members in arrears after a certain period of time, he wondered whether it also stopped negotiating projects. Finally, he took note of the following sentence on pages 8-9 of EBS/84/211:

Detailed discussions might be required for a program following the elimination of arrears, and the prospect that further time might be needed should provide an added incentive for members to remain current, or become current promptly, with the Fund.

It was to be hoped that that sentence would not be read as allowing additional time to be wasted before repayment.

The Treasurer noted Mr. Polak's suggestion for incorporating a protective clause in each decision on a request for purchases under the Fund's special facilities. The procedure could in his view be implemented, but he would need to consult with the Legal Department on the most appropriate technique. On Mr. Polak's second point, information on the World Bank's policy regarding arrears could be incorporated in the next six-monthly report. Finally, the intention of the staff in the statement to which Mr. Polak had referred had been to encourage members to speed up payments rather than to delay them further.

Mr. Nimatallah expressed the hope that information requested by Mr. Polak on the World Bank would not be used as part of an effort to compare the two institutions in their dealings with arrears. Other organizations, particularly development organizations, disbursed their resources over a longer period of time because of the nature of the projects they financed. As a result, they had greater control over those disbursements and the uses to which they were being put than was possible in the Fund. Moreover, the concept of disbursements should not be confused with the Fund's concept of new credits or its policy on access. The Fund was a unique institution and should establish its procedures on the basis of its own needs.

Mr. Polak, taking note of Mr. Nimatallah's point, wondered whether it would not be better if the Treasurer were to provide the information that he had earlier requested on the World Bank in a separate paper rather than in the next six-monthly report.

Mr. Zhang asked what advice would be given to a country that found itself in so much difficulty that it could not repay either the Fund or the commercial banks. Would the member be advised by the Fund to borrow further from the commercial banks in order to repay the Fund?

The Chairman replied each case would have to be looked at separately. It was difficult to say how the Fund should treat a member that could make no payments to any creditor because of circumstances beyond its control; he personally had never encountered such a case. If a cataclysmic situation should arise in which a country was completely overwhelmed by, say, typhoons, there were procedures available under the Articles. However, the justification for invoking those procedures was the responsibility of the member, which would have to demonstrate that repayment to any creditor was impossible.

The Chairman then made the following summing up in concluding the discussion:

The following points were brought out clearly in the discussion of the six-monthly report on overdue financial obligations to the Fund.

General remarks

1. The Board expressed its concern about recent developments relating to overdue payments to the Fund. Although the amounts of arrears to the Fund remained relatively small and were limited to a few countries, Executive Directors noted that the number of members in arrears had grown in recent months and that there had been a tendency toward an increase in the amounts and a lengthening of the duration of the arrears. Directors considered that the situation was serious and that it must be addressed with clarity, determination, and evenhandedness. Many Executive Directors stressed that, if the situation were allowed to deteriorate, the

monetary character of the Fund, the revolving nature of its resources, and the credibility of the institution as a centerpiece in the international monetary system might be endangered.

2. Although no major changes appeared to be needed at present in the policies agreed upon at EBM/84/54 and EBM/84/55 (4/5/84), Directors considered that the time had come for some clarification and/or strengthening of certain procedures for dealing with overdue financial obligations to the Fund.

Discussion topics and staff recommendations
(pp. 19-20 of EBS/84/211)

1. The proposals included in paragraph 1, which, in essence, tended to tighten somewhat the timetable for the consideration of complaints by the Board, were acceptable to Directors.

2. The suggestions contained in paragraph 2, which dealt with those members experiencing continuous overdue obligations to the Fund, were acceptable to the Board. There were, however, a number of Directors who thought that greater consistency with the treatment of the type of arrears dealt with in paragraph 1 would be preferable.

3. There was some apprehension among Directors about making reviews of the Board's decisions on complaints a standard feature of the procedures because that might be interpreted as providing a grace period. This was neither the intent of the drafters of the paragraph, nor the understanding of the Board. It was agreed that Executive Board reviews of decisions on complaints should normally not extend beyond three months and could be shorter, depending on the circumstances.

4. The Board agreed that reviews of programs should not be completed while the relevant member was in arrears. However, Directors stressed the need to keep the channels of communication open between the Fund and the member. Contact could be maintained through special ad hoc technical missions, Article IV consultations, or even, in some circumstances, review discussions under an existing program; however, in the third type of cases, reviews would not be brought to the Board for consideration before the elimination of the arrears. All those contacts would be intended to assist the member to meet its obligations to the Fund. In that regard, a number of Directors had stressed the need to avoid any connotation of punitive action, a concern that would certainly guide management and staff in arranging and carrying out those contacts. It seemed clear from the discussion that management should be endowed with the flexibility to make whatever arrangements were necessary to maintain a dialogue with members.

5. The question whether or not to give publicity to certain factual information on members' overdue obligations to the Fund would be considered further on December 7, 1984, when the Board would discuss a paper on the effects of overdue obligations on the Fund's income and their treatment in the Fund's financial statements.

6. There was no majority at present in favor of imposing penalty charges on members with overdue obligations to the Fund. However, a number of Directors asked the staff to prepare a paper exploring the different aspects of the subject.

7. The suggestions in paragraph 7, which clarified the present practice under which a member could make no purchases while in arrears, were accepted by the Board. Draft decisions would be prepared shortly for Board examination and approval.

Other comments

In addition to their remarks on the suggested topics for discussion, a number of Directors placed heavy emphasis on various points that they felt were related to the discussion. Some insisted that greater attention should be paid to the role of exogenous factors beyond the control of members in the increases in arrears and in the delays in eliminating them.

A second point of emphasis was related to the need for even-handedness and for maintaining the credibility of the Fund. Without underplaying the adverse external economic environment that might in part explain the overdue payments problems, a number of Directors stressed that it was extremely important--for the sake of the cohesion of the Fund and its cooperative character--that all countries perform their obligations in a fair and evenhanded way.

Another line of thought made a distinction between (a) the importance of ensuring that overdue payments, once they arose, were taken care of and (b) the need to prevent the emergence of overdue payments in the first place. In the months ahead, the staff would be examining methods of determining and reducing the potential for problems in members' relations with the Fund, using the opportunity afforded by various forms of contact with member countries to warn them of possible dangers and help to devise ways of averting such problems.

Let me add that, in my personal view, the problem of overdue obligations to the Fund is a very serious matter, which must be tackled without delay. At the moment there are not many countries in arrears, but, if we do not act now, the number could increase significantly. Sizable repurchases will be coming due over the

next two years, and the Fund must therefore take the appropriate measures to demonstrate the importance that it attaches to arrears. The Fund is not a creditor like other creditors; it is the cornerstone of the international monetary system and must not be treated as other creditor institutions may be treated, particularly in terms of rescheduling. The Fund must preserve its credibility; and if it is considered desirable for the institution to continue to assist member countries that are facing structural weaknesses and difficulties, it must be demonstrated that Fund loans are indeed serviceable and repayable in a timely way. If the Fund gave the impression that some countries, because they were experiencing particularly severe hardships, would not be expected to meet the timetables and the obligations pertaining to Fund programs, then the institution would probably find it difficult to continue providing the assistance that members were accustomed to receiving.

I have always taken the view that we should stand ready to assist all members, including those which have severe structural difficulties; but this can only be done if they understand that the continuation of Fund support in the years to come is very much dependent on their meeting their obligations to the Fund. Such countries will have to orient their priorities toward repaying the Fund, even under difficult external circumstances. It must be understood that repaying the Fund is of critical importance, not only for the functioning of the system but also for the continuation of the Fund's ability to provide financial assistance. That is why I personally have little sympathy for the notion put forward today by some speakers that it is important to distinguish between the so-called recalcitrants--the ones that may have a negative attitude toward repaying the Fund--and those that are affected by various unfortunate external conditions. If we posed the problem in that way, we would quickly reach a point where the membership would call for an overhaul of our lending policies; hence, I think we have to make all countries understand that payments due to the Fund must be made on a regular and timely basis.

One of the major goals of missions to countries that have made use, or want to make use, of Fund resources is to ensure that repurchases according to our normal timetables will be digestible by the member. We try not to overload those countries with too heavy repayment obligations. I think that we have followed that principle, and it is thus all the more important that these countries do not fall into arrears and build up amounts that are difficult to repay. That problem can be avoided if countries keep their priorities in order and meet their obligations according to the schedule agreed upon. If that were not possible, the Fund would have failed in a fundamental aim and a fundamental responsibility. However, I have heard of no

case where the discharge of a Fund obligation on time was an absolute impossibility. I note that some countries in dire straits sometimes have been tempted to give higher priority to other types of payments, and this in my view is an approach that we must not accept, because of its systemic implications. In sum, I believe that we should continue to be flexible but clear in our resolve to eliminate payments arrears to the Fund.

2. IBRD - RELEASE OF INFORMATION

The Chairman noted that he had received a request from the Secretary of the World Bank that a recent staff paper on Fund/Bank collaboration and the adjustment process (SM/84/242, 10/30/84) be circulated to the Bank's Executive Directors.

The Executive Board approved the request from the Secretary of the World Bank.

Adopted November 19, 1984

APPROVED: August 21, 1985

JOSEPH W. LANG, JR.
Acting Secretary

