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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 84/54

9:00 a.m., April 5, 1984

J. de Larosière, Chairman

Executive Directors	Alternate Executive Directors
	W. B. Tshishimbi
	H. G. Schneider
	X. Blandin
	M. Teijeiro
R. D. Erb	M. K. Bush
M. Finaish	T. Alhaimus
T. Hirao	T. Yamashita
J. E. Ismael	Jaafar A.
R. K. Joyce	
A. Kafka	
G. Laske	
G. Lovato	
R. N. Malhotra	A. S. Jayawardena
Y. A. Nimatallah	J. E. Suraisry
J. J. Polak	T. de Vries
A. R. G. Prowse	K. G. Morrell
G. Salehkhou	O. Kabbaj
	E. I. M. Mtei
M. A. Senior	
J. Tvedt	
N. Wicks	T. A. Clark
Zhang Z.	Wang E.

J. W. Lang, Jr., Acting Secretary
J. A. Kay, Assistant

Also Present

African Department: O. B. Makalou, Deputy Director; A. C. Woodward. Asian Department: W. G. L. Evers. European Department: L. A. Whittome, Counsellor and Director; R. H. Nord. Exchange and Trade Relations Department: C. D. Finch, Director; D. K. Palmer, Associate Director; W. A. Beveridge, Deputy Director; S. Mookerjee, Deputy Director; H. W. Gerhard, M. Guitian. External Relations Department: N. K. Humphreys. Legal Department: G. P. Nicoletopoulos, Director; J. G. Evans, Jr., Deputy General Counsel; G. F. Rea, Deputy General Counsel; Ph. Lachman, A. O. Liuksila, S. A. Silard. Middle Eastern Department: F. Drees. Treasurer's Department: W. O. Habermeier, Counsellor and Treasurer; D. Berthet, W. L. Coats, D. S. Cutler, D. Gupta, A. W. Lake, T. Leddy, M. L. Peery, D. V. Pritchett, T. M. Tran, P. van den Boogaerde, G. Wittich. Western Hemisphere Department: S. T. Beza, Associate Director; M. Caiola, R. A. Elson, J. Ferrán, M. R. Figuerola, A. M. Jul, T. M. Reichmann, S. C. de Sosa. Personal Assistant to the Managing Director: S. P. Collins. Advisors to Executive Directors: E. A. Ajayi, H. A. Arias, S. E. Conrado, J. Delgadillo, S. El-Khouri, S. M. Hassan, L. Ionescu, G. E. L. Nguyen, Y. Okubo, P. Péterfalvy, M. Z. M. Qureshi, D. I. S. Shaw. Assistants to Executive Directors: E. M. Ainley, R. L. Bernardo, J. Bulloch, M. B. Chatah, L. E. J. M. Coene, G. Gomel, V. Govindarajan, D. Hammann, N. U. Haque, A. K. Juusela, H. Kobayashi, M. J. Kooymans, E. Landis, E. Portas, M. Rasyid, J. Reddy, A. A. Scholten, S. Sornyanyontr.

1. OVERDUE PAYMENTS TO FUND - EXPERIENCE AND PROCEDURES

The Executive Directors considered a paper dealing with experience and procedures on overdue payments to the Fund (EBS/84/46, 3/9/84).

Mr. Nimatallah made the following statement:

As I have said many times, my authorities are firmly committed to a financially strong Fund that can respond effectively to the needs of borrowing countries and give creditors assurance that they will be repaid. A financially strong Fund is in the interests of all its members.

My authorities hope that all members will cooperate to keep the Fund financially strong. They fully support the policies already established to safeguard the Fund's financial position. They are, however, concerned that there is no clear and consistent policy to guide management in cases where members do not repay the Fund on the due dates. Such a policy is essential to protect the Fund's creditworthiness and its image in the international financial community.

The staff paper on the subject is, therefore, pertinent and timely. It is clear from this paper that the problem of overdue payments is growing. The problem could also worsen, given the large increase in repurchases falling due over the next few years.

This is disturbing. The resources of the Fund are made available on a temporary and revolving basis. Failure to repurchase on time weakens the Fund's liquidity and reduces the resources available for other borrowing countries. It could also weaken the confidence of Fund creditors, and undermine the credibility of Fund-supported programs. As the Managing Director said, in his speech in Cincinnati on March 16, "the viability of the Fund depends upon borrowing countries' repaying their loans within a relatively short period."

For these reasons, my authorities believe that the Fund should formulate a clear policy on how to deal with this problem. They welcome the steps that the Fund has already taken to improve its procedures for encouraging members to repay on time. They also endorse the Fund's firm stance against postponing or rescheduling repurchases. But my authorities doubt whether these procedures and policies are sufficient, since some members are still failing to meet their repurchase obligations.

Saudi Arabia, therefore, believes, that stronger, more effective policies are now required. The staff examine a number of policy options, in particular:

(1) initiating procedures that could lead to a limitation of a member's right to use Fund resources, or to ineligibility, if payments are still outstanding after a relatively short period of, say, six months;

(2) imposing penalty charges on holdings of members' currencies that have not been repurchases on schedule; and

(3) giving publicity to the fact that the Fund is taking procedures against a member with respect to overdue payments.

These policy options should be carefully considered. They go very much in the right direction. However, my authorities feel that more is needed to achieve the right combination of firmness and discretion. The Fund should give members every opportunity and incentive to repay sooner rather than later, but leave them in no doubt of the consequences of not repaying. My authorities believe that this could best be achieved if the Fund applied its sanctions in stages and made them stronger the longer repayments were delayed. The following is one possible approach.

In cases where the member has no outstanding programs with the Fund, the Fund could proceed in four stages:

Stage 1: Three months after the due date, the Fund would issue a clear warning to the member, stating that the Fund would start ineligibility procedures unless the member repaid within the next three months. At the same time, to give the warning teeth, the Fund would immediately impose penalty charges for the next three months. At this stage, it would, I think, be appropriate to make the penalty such as to eliminate the concessionality element in Fund charges. The member would thus have two incentives to repay the Fund within six months of the due date.

Stage 2: After six months, if the member had still not repaid or shown no intention to repay, the Fund would start ineligibility procedures. At the same time, the Fund would warn the member that failure to repay within a further 45 days would lead the Fund to make public the fact that it was taking this sanction against the member. The Fund would also increase the penalty charges sufficiently above market rates so that it would then be worthwhile for the member to borrow from other sources to repay the Fund.

Stage 3: If, after the 45 days, the member had still not repaid or shown no serious, clear intention to repay, the Fund would inform the banks and other official lenders and urge them to suspend any further loans until the member repaid the Fund. The Fund has been cooperating with the banks in helping countries to repay their commercial debt; and the banks should, therefore, cooperate fully with the Fund in cases where member countries are not repaying their debt to the Fund. It is essential that

banks support the Fund in exerting pressure on member countries that reach this stage without showing any intention to repay.

Stage 4: If, after seven and a half months, the member had not shown any intention of repaying, the Fund might have little choice but to consider the ultimate step of compelling the member to withdraw from the Fund. The Board would, of course, have to exercise considerable discretion before such a serious step was taken. This sanction would therefore be required only in very extreme circumstances.

In cases where a member falls overdue in its payments when discussing a new program, the Fund has the immediate sanction of suspending talks until outstanding payments have been settled. This is now standard Fund practice and should be continued. The present practice of not submitting requests for Fund resources to the Board if members have overdue payments should also be continued. If a member remains interested in a new program, yet fails to make repurchases after three months, the Fund should then be free to treat that member in the same way as I have just outlined.

Finally, in cases where a member falls overdue in payments during an ongoing program with the Fund, the present procedures could be strengthened. According to the staff paper, the Fund cannot, legally, refuse a purchase, once a program has been agreed, if a member with overdue payments is complying with the performance criteria. This is understandable in the light of the continuing cooperation between the Fund and the member. At the same time, however, Fund programs usually include, as one of the performance criteria, the reduction or elimination of payments arrears to other creditors.

In the light of this, I wonder whether something similar could be added to strengthen the Fund's position in case of delays in repurchases during the life of a program. It would be consistent and prudent for the Fund to let members know, in advance, that failure to repay the Fund could interrupt their drawing rights. One way of doing this would be to add a new performance criterion, in all arangements, making purchases conditional on a member's reducing and eliminating late payments to the Fund. 1/ Such a performance criterion could be implemented with discretion, on a case-by-case basis.

In conclusion, I would emphasize again that my authorities' objective is to keep the Fund financially strong and ensure that the Fund's resources remain secure and available for all its members in the future. They believe that the Fund should have a

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1/ It would be up to the Board to decide whether to incorporate this criterion, if adopted, only into new programs or to introduce it also into existing programs that are interrupted and/or renegotiated. I have an open mind on this matter.

firm and clear policy in this area; they also believe that this policy should be implemented with discretion and flexibility.

Mr. Kafka made the following statement:

We are confronting today overdue obligations incurred by two of our member countries, Guyana and Nicaragua. I would like first to make some general comments on the problems of overdue obligations and how to deal with them.

It is clear that the accumulation of overdue obligations to the Fund is one of the many reflections of the general debt crisis. It is also clear that the Fund must safeguard its position. Without necessarily questioning that the Fund's claims should not be rescheduled like those of other creditors, that does not mean that other forms of postponement may not be justified. Obviously, the Fund under the Articles has an obligation to safeguard the temporary nature of the use of its resources, but the Articles themselves foresee in Article V, Section 7(g) the possibility of postponing repurchases, consistent with the temporary use of the Fund's resources in case of exceptional hardship for the member, if a special majority of 70 percent agrees. I submit that it is incumbent upon the Fund to investigate the presence or not of exceptional hardship, before taking decisions where such hardship may be relevant. Furthermore, under Article V, Section 8(e), the Fund may allow a country to pay charges in its own currency, a decision requiring only a simple majority.

The staff argues that rescheduling would not materially facilitate repayments to the Fund or contribute to the adoption of appropriate adjustment policies. It seems to me that this cannot be determined a priori In fact, it seems to me likely that in many cases, if we agreed to postpone action against a country for a limited time provided that country adopted a satisfactory adjustment program, repayment would be facilitated, for an additional incentive would then be created for a country with overdue obligations to accelerate the adoption of an appropriate adjustment program.

The staff submit for our consideration three general questions. First, the staff ask whether we should establish a fixed period after which the Managing Director would normally submit a complaint under Rule K-1 or S-1. I think rigid rules have to be eschewed; they may be counterproductive. The second question is whether penalty rates should be levied in the case of overdue obligations. I agree with the staff that, as in the past, this could be harmful rather than helpful. Finally, the staff ask what kind of publicity we should give to action that might be taken by the Executive Board with respect to members with overdue payments. In my opinion, this will have to be decided ad hoc, but it seems to me that it is not appropriate for the Fund to engage the media in these matters.

Mr. Senior stated that he broadly supported much of Mr. Kafka's argument. The timely discharge of obligations to the Fund was of course important if the Fund were to maintain its credibility and efficiency, and thus to play its proper role in the international adjustment process. The growing incidence of overdue payments in the past few years had been a consequence of the debt crisis and not of a change in the basic perception of members' regarding the importance of remaining current in their payments to the Fund. Even in the present situation, where there were evident strains on the international financial system, and the developing countries were in a critical situation insofar as debt was concerned, the problem of overdue payments to the Fund was still relatively small compared with total payments made to the Fund each year and to Fund credit outstanding. Nevertheless, the increase in overdue payments clearly justified the review of present practices and procedures, to see whether any modifications were needed.

In the present uncertain international economic environment, Mr. Senior went on, it could have been expected that the scale of the problem would have been considerably larger. While the commitment of members to a strong Fund had clearly been of paramount importance, the current practices and procedures for dealing with overdue payments had also played a role in maintaining the present high standard. The flexible approach adopted by management seemed to have served the Fund well; a more rigid attitude might be counterproductive. The present flexible approach, under which members were treated on a case-by-case basis, had in most instances provided a suitable vehicle for eliminating overdue payments in a relatively short time. Management had had the required degree of freedom for dealing with the problems without generating friction between the Fund and the members concerned. A more rigid approach might well provide grounds for possible confrontation, more protracted delays in payments, and an impairment of the Fund's credibility and its credit standing as a borrower. It seemed clear from the staff paper that the current flexible practices did not mean an absence of established criteria or excessive degrees of freedom. As they had served the Fund well, he preferred to retain them or, at the least, to avoid introducing rigid rules that in the end might prove counterproductive.

As to the possible introduction of a penalty rate for overdue payments, Mr. Senior remarked that the staff paper presented convincing arguments against such a change. The analysis of experience in regard to payments to the Fund strongly suggested that the level of interest rates or the absence of a penalty rate had not greatly influenced the timing of the discharge of members' obligations. In view of the subsidy implied in Fund charges and the absence of a penalty rate, it would always have been profitable for members to delay paying the Fund. Nevertheless, such delays had not occurred in the past. Increases in overdue payments had moved more in line with the strains in the external payments situation in general. Logically at least, because Fund charges were low, very high rates of penalty would be needed if an effective pecuniary negative incentive were to be created to encourage prompt payment. Such a large increase in charges would however further aggravate the payments problems of members in arrears, thus making it even more difficult for them to discharge their obligations.

Regarding publicity, Mr. Senior commented that it would be desirable for the Fund to mention such matters in the media only after drastic action had been approved, and only then in extreme cases. Otherwise, the use of publicity would also be counterproductive. Members that incurred protracted overdue payments to the Fund could clearly be expected to be confronting a difficult financial situation, so that it would be almost impossible to discharge such obligations from their own resources. Countries in such a position might have to obtain borrowed resources in order to reschedule their overdue payments to the Fund; the use of publicity by the Fund would surely make it impossible for them to obtain such resources.

Commenting on the possibility of rescheduling payments to the Fund either within the normal repayment period or beyond, Mr. Senior noted that the staff had argued against such rescheduling, basically on the grounds that it was unlikely materially to facilitate repayment to the Fund, or to contribute to the adoption of adjustment policies likely to solve the underlying balance of payments problems. Like Mr. Kafka, he had not found such arguments convincing. Naturally, recurrent reschedulings without the adoption of any adjustment policies would not in themselves contribute to the future discharge of the overdue obligations, and might even contribute to the postponement of the adoption of the required stabilization policies. However, a rescheduling of payments to the Fund that was agreed upon in conjunction with the adoption of appropriate adjustment policies should facilitate future repayments. After all, that was basically what was done for many members with debts to other creditors. Moreover, provision for such a solution was contemplated by the Articles of Agreement, which stated that, in the event of exceptional hardship for a member, the Executive Board might by special majority postpone repurchases. While such rescheduling should not take place more or less automatically, the presence of exceptional hardship should be investigated in relevant cases.

Mr. Ismael stated that he too would like to endorse fully all the views expressed by Mr. Kafka. He hoped that the Executive Board would accept his advice and suggestions. It was clear from what Mr. Kafka had said that the absence of established procedures could be an advantage, in that it provided scope for flexibility and innovation in dealing with individual countries.

It was heartening to know that, so far, no member had defaulted on its financial obligations to the Fund, Mr. Ismael observed. It was also heartening to read that overdue payments to the Fund remained a small proportion both of total payments falling due and of total Fund credit outstanding. Nevertheless, the staff had expressed concern about the increase in the incidence of overdue payments, without actually attempting to explain the phenomenon. He himself wondered whether the rise in the number of overdue obligations was in any way linked to the extremely difficult global economic and financial situation. If a relationship did exist between overdue obligations and the economic and financial conditions in the world economy, he wondered whether there would be an improvement in the figures when the world economy began to improve. If so, there might not be any great advantage in adopting rules and procedures to deal with what would

then appear to be a relatively minor problem. He preferred to adopt a case-by-case basis that would make it possible to take account of a number of different cases, ranging from one where overdue obligations arose as a result of unwillingness of the member to pay, to one where a member simply lacked the means to pay.

In those cases where overdue obligations had arisen as a result of inability to pay, Mr. Ismael observed, and where the member concerned was willing to adopt an adjustment program, the existence of overdue obligations should not stand in the way of negotiations, or of Executive Board consideration of a new request for the use of Fund resources. Such a request might either be granted conditionally, subject to the member settling its overdue obligations, or in a "back-to-back" arrangement, whereby the proceeds of a new drawing on the Fund could be used to discharge outstanding obligations. He made the suggestion because it seemed to him that Executive Directors were excessively preoccupied with preserving the revolving nature of Fund resources and were in danger of forgetting their real objective, which should be to persuade members in difficult balance of payments positions to adopt appropriate adjustment measures. If by postponing repayments or by granting new credits at a time when there was an outstanding obligation, the Fund could persuade a member to undertake adjustment as a means of attaining a viable balance of payments position, the Executive Directors should not hesitate to move in that direction. He fully agreed with Mr. Kafka that if countries with appropriate adjustment programs were given more time, they would have a far better chance of making repayment.

Responding to the three questions raised by the staff, Mr. Ismael stated that he was not in favor of establishing a fixed period after which the Managing Director would lodge a complaint under Rule K-1 or Rule S-1. He would prefer a flexible approach that would provide room for discretion and for political accommodation. Such elements were essential in dealing with members who were, after all, sovereign states. On the question of whether a penalty rate of interest should be levied, his chair was strongly opposed. Members with overdue obligations were clearly in a difficult situation, and charging a penalty rate of interest would only compound their woes. As to publicity, he favored dialogue and diplomacy as opposed to adverse publicity, which, in his view, would not solve the problem of overdue obligations. Indeed, it seemed likely that such publicity might be seen by the international community as a sign of bad judgment on the part of the Fund and a reflection of the ineffectiveness of Fund programs. He would therefore strongly oppose any publicity on overdue obligations.

Regarding the postponement or rescheduling of debt owed to the Fund, Mr. Ismael noted that the staff had argued that because Fund resources were of a revolving character, no rescheduling could be allowed. Nevertheless, during the past few years the Fund had played a very active role in debt rescheduling by commercial banks, and had indeed persuaded some of them to increase their exposure in certain countries. Commercial bank resources were also of a revolving character; deposit liabilities, with which banks financed their assets, had on average a much shorter maturity than the liabilities with which the Fund financed its drawings by member countries.

In other words, the Fund was in a better position to reschedule payments owing to it than were commercial banks. In those circumstances, he would not be particularly averse to the idea of providing debt relief to members in a very serious balance of payments position.

Mr. Erb recalled that it had been almost two years previously (EBM/82/43, 4/7/82) that he had raised the subject of overdue payments to the Fund in an Executive Board meeting. At that time, he had said that he was concerned by the adoption of a case-by-case approach by the Executive Directors in relation to the general subject of arrears, and that he had expressed similar concerns during the Executive Board discussion in connection with Sudan that had taken place during the previous year (i.e., in 1981). He had gone on to say that it would be a mistake to continue using a case-by-case approach before considering all of the policy issues connected with arrears. To avoid any future problems that might arise, the staff should be asked to consider all the issues involved.

He therefore welcomed the current Fund staff paper, which laid out all the issues involved in connection with overdue payments to the Fund, and he would like to comment on the proposals and recommendations made by the staff, Mr. Erb continued. While he was sympathetic to the authorities of many countries that had difficulty in meeting payments to the Fund, and to other institutions as well, he would emphasize the importance of the Executive Board's adopting policies and practices that made it absolutely clear that overdue payments to the Fund weakened the Fund in a variety of ways and were therefore unacceptable.

The staff had cited a number of reasons why the existence of overdue payments to the Fund undermined the Fund and its operations, and he would emphasize two of them, Mr. Erb remarked. Overdue payments to the Fund certainly affected the public perception of the Fund as a monetary institution, particularly if there were a large number of countries with overdue payments, and if those overdue payments were outstanding for long. He would also lay emphasis on the potential impact of the existence of a large number of arrears on the catalytic role of the Fund, seeing that the major feature of the catalytic role was to induce other lenders to provide resources to a country at the same time as the Fund. There was also an issue of uniformity of treatment for the membership. It was unfair to countries that made every effort to make payments to the Fund on time to take a lax approach to those countries that delayed payment. Moreover, as was clear from the staff paper, when a large number of countries were behind in their payments to the Fund, there would be a cost to the Treasurer's Department, thus in effect raising the cost of money to all members.

Commenting on the conclusions and recommendations by the staff, Mr. Erb stated that he would strongly agree that the Fund should be providing technical assistance in any way that it could to help countries develop the means of quickly making payments to the Fund and, of course, to other creditors. It was important to apply practices with respect to overdue payments in a uniform manner. The Fund should not reschedule purchase obligations if a member represented that it had difficulty in meeting its financial

obligations to the Fund within the normal repayment periods, nor should it stretch repurchases beyond those periods. The arguments put forward by the staff were quite compelling. He also agreed with the staff that the Fund should not postpone the fulfillment of repurchase obligations to itself when a member had sought rescheduling in a Paris Club negotiation or in any other forum.

When there were negotiations involving the potential use of Fund resources, the conduct of those negotiations should be made contingent upon the prompt settlement of overdue obligations, Mr. Erb stated. In addition, when a request for the use of Fund resources was submitted to the Executive Board, there ought to be a short statement by the Treasurer's Department reviewing the past performance of the country in meeting its obligations to the Fund, at least in those cases where there had been difficulties, showing why there had been delays in repayment and how the repayments had ultimately been made. Fund programs ought to include an explicit performance criterion that would prohibit purchases when a country was in arrears to the Fund in the course of a Fund program.

The staff had discussed the case for levying penalty charges, Mr. Erb recalled. It would be appropriate to impose a penalty charge upon countries that became overdue in making repurchases from the Fund, for the purpose of covering at least the implicit cost involved in such delays. The charge should however be a market-related one, and he would choose some standard market rate such as LIBOR or a prime rate. He also agreed with the practice of calling for additional payments when payments or transfers were made later than the due date.

Taking up the question of what the Fund should do in cases where outstanding arrears had existed for some time, Mr. Erb stated that in general he agreed with Mr. Nimatallah's remarks. There were however two of his proposals that were less easy to accept. First was the proposal that the Fund should, after a given period of time, encourage banks and other sources of credit not to lend to a country that was in arrears to the Fund. Such an arrangement would make it difficult for the country to deal with its arrears. Second, he would not like to see a presumption created that if a country had been in arrears to the Fund for some time, that country might be expelled. Any action of that sort ought to be taken on a case-by-case basis; it was not the sort of action that ought to be forthcoming routinely if a country were in arrears, even for an extended period of time. The value of Mr. Nimatallah's statement was that it did contain explicit guidelines for handling arrears, and it did make quite clear what action would be taken if the arrears were not settled within that time.

As he understood Mr. Nimatallah's proposals, Mr. Erb commented, the burden of explaining why an action should not be taken would lie on the country, not on the management and the Executive Board. That approach seemed to him the correct one; countries should be expected to take action to repay the Fund within given periods of time, or, if they did not do so, countries should expect responses on the part of the Fund, and it would be up to the countries to explain the special circumstances that might justify

some leniency. He could not wholly follow Mr. Kafka's approach, which placed the burden of proof on the Fund management and the Executive Board to show why a country should be penalized if it fell behind in its payments to the Fund. The burden of proof for showing that a penalty should not be applied ought to lie with the country.

Mr. Nimatallah stated that he did not disagree with Mr. Erb that a country should be dismissed from the Fund for failure to meet its obligations only on a case-by-case basis, with a great deal of discretion being allowed to the Executive Board. He had no intention of suggesting that expulsion should be a routine affair. Second, he had not intended to say that banks should be discouraged from lending to those countries that were behind in their payments to the Fund. His intention was that after it had been found impossible to proceed any further with the member, an announcement should be made. As he saw it there would be two steps: first an announcement, and then moral pressure on commercial banks to prevent them from lending to the country that was in arrears to the Fund.

Mr. Kafka said that he wished to maintain the Fund's present practices with regard to overdue obligations.

Mr. Prowse explained that his chair viewed the matter of overdue payments from the standpoint that the welfare and strength of the Fund itself were paramount. The welfare of individual members could only be sustained as part of a strong Fund, which should have unimpeachable standing and untarnished credibility. He had concluded that the problem posed by the staff was not very great, and that it should be treated accordingly. Nevertheless, it was sufficiently important to warrant consideration being given to it. Finally, the number of cases was sufficient and the difficulty was great enough to warrant some further guidance being provided by the Board to management and staff on how to deal with the situation.

Under the rather loose set of rules in force, it was clearly difficult for management and staff to deal with overdue payments, Mr. Prowse considered. The staff's suggestions for some systematization seemed reasonable, and the Board should react with understanding. A point to be borne in mind was the public perception of any decision that might be taken, or any extension of policy. The question of publicity, not merely for individual overdue payments, but also for the policy as a whole, needed to be carefully considered. It was important not to give the wider public an impression that the Fund had a serious problem on its hands. The principles and practices evolved by management to respond to instances of overdue payments were quite satisfactory; nevertheless, he was prepared to examine the staff proposals in a favorable light, especially as he believed that late payments--certainly of a nontechnical nature--should not be allowed to increase.

He would see merit in the proposal for systematizing procedures, including that of limiting members' access to Fund resources, Mr. Prowse continued. In principle, there should be a relatively short period within which action should be initiated following failure to make payments; a period of six months would be sensible. Nevertheless, there should be no

irrevocable constraint on the action available to the Board or the management. It would be most undesirable if adopting a six-month trigger period as a guideline meant eliminating any flexibility for application in individual cases. He wished to be sure that the management would have the opportunity to propose a variation of procedure in any particular case if there were special circumstances. Mr. Nimatallah's suggestion that, where implementation of action was required, some early advice from the management to the authorities would be appropriate, say, after a three-month period, was acceptable. He was not worried that the six-month period might be considered a grace period, although the threat of action in six months' time might support the moral persuasion that the Fund had no doubt been trying to apply in the interim. In brief, he would not object to the Managing Director's giving informal advice after three months, and a six-month trigger period would be acceptable provided that there was scope for flexibility in particular cases.

On the question of penalty charges, it was necessary to draw a distinction between technical late payments and nontechnical late payments, Mr. Prowse commented. With some experience in the field, administrative delays might be reduced if the prospects of penalty charges had the effect of focusing attention on the need to make payment. On the other hand, where nontechnical overdue payments were concerned, the Fund should regard the matter as serious, even if penalty charges might exacerbate the difficulties that underlay the delays. Consequently, while penalty charges might be useful in reducing significant technical delays, it seemed unlikely that they would be very successful in connection with nontechnical overdue payments. He would not like to take a decision on the matter during the present meeting; it should be kept in mind for further consideration depending on trends in overdue payments.

Regarding publicity, Mr. Prowse observed that he hoped that the present discussion would not receive adverse publicity, and that any decision should be made known to the membership in an appropriately delicate manner. On the other hand, it was difficult to see why other Fund members should not be aware of the existence of overdue payments. The real question was whether the wider financial community had an entitlement to know. It seemed likely that in almost all cases where nontechnical overdue payments had occurred, the matter would become public in one way or another, but should the Fund seek to publicize delays in payment? Whatever the Fund did, it should not act in a heavy-handed fashion. He saw no need for the Fund to adopt a procedure for publication, except for ensuring that appropriate papers were circulated to Executive Directors. Informing commercial banks when payments became overdue to the Fund would be inappropriate.

There was no reason to permit the rescheduling of overdue payments to the Fund, Mr. Prowse commented. Adopting such a procedure might well be detrimental to the Fund's credibility and to its financial standing. Rescheduling, once begun, might become significant on the basis of equal treatment, and any significant rescheduling would surely have implications for the nature of the Fund's role, which was to be a source of short-term to medium-term conditional balance of payments support. He would on principle therefore not support the rescheduling of Fund purchases.

Mr. Polak remarked that overdue obligations to the Fund were incompatible with the temporary and revolving character of the use of its resources. They undermined the Fund's liquidity and its ability to assist other members, and they weakened confidence in the Fund on the part of the contributors of the Fund's resources, who, for their part, wished to see their positions, if anything, became more liquid. If confidence were undermined, the future supply of Fund resources, whether as quotas or as loans, would be jeopardized. The Fund should therefore make every effort to encourage members to pay on time and not to tolerate more than minor slippages.

Taking up the six points made by the staff, Mr. Polak said, first, that if a slippage occurred for anything but the briefest time, the Fund should take action under the K or S Rules. The precise time at which such action should be proposed to the Executive Board ought to be determined by the management. There should be no minimum period, but the maximum period should not exceed six months unless the Managing Director saw a good reason for a short extension. Those two points seemed to be embodied in the present practices, and they should be retained. There was no recent experience that would justify either hardening the procedure on the basis of a preset timetable for successive steps, leading to expulsion, or for softening it by side-stepping the first step laid down in Rules K-1 and S-1.

Action on publicity ought to be decided on an ad hoc basis, Mr. Polak went on. In general, he was not in favor of publicity; however, countries that were overdue in their payments to the Fund had probably lost their access to commercial banks some time previously. The matter of publicity was therefore perhaps less important than it seemed.

As to the postponement of scheduled repurchase obligations, Mr. Polak said that he agreed with the staff that the number of occasions on which a postponement would be useful would be few. The only occasion he could imagine would be one on which it was clear that the member would be in a better position to discharge the obligation on a new due date. He agreed with the staff that members overdue in their payments should repurchase from the Fund before the Fund negotiated a new arrangement with them, and that when an arrangement had been concluded it should not be submitted to the Board if overdue payments were outstanding. He would favor including a standard provision in all arrangements that would prevent members with overdue payments from being in a position to draw. The present practice whereby the member was merely asked not to draw was unsatisfactory.

On the question of penalty charges, Mr. Polak stated that he did not believe that they would normally be a useful instrument. The negative effect of the member's having lost its credit standing with the Fund, with or without publicity, would be a much more severe penalty than could be provided by insisting on a penalty charge. It was difficult to imagine that a member that could readily make repurchases from the Fund would not do so. In the rare instances when a member had decided to break with the Fund, the penalty charges would not help. However, the imposition of penalty charges, like other elements in the action to be applied to a country, could be decided in individual cases.

Mr. Malhotra stated that he agreed with many other speakers that the problem of overdue payments to the Fund was not a serious one. From Table 3 on page 21 of EBS/84/86 it would be seen that on Febuary 10, 1984 there had been 11 cases in which countries had been overdue by between two and six weeks, and only three cases in which countries had been overdue for six weeks or more. While over the two later weeks the number of countries overdue in their payments to the Fund by more than six weeks had risen from three to seven, it was clear that the period of late payment in the four additional cases could not have exceeded eight weeks.

It was a salutary rule that regulation should be changed only when there was a widespread problem that needed tackling, Mr. Malhotra observed. Experience showed that the present rules had served the Fund well by ensuring, first, that payments were made on time and, second, that if there were any delays, they would be only for short periods. Moreover, existing practice had been useful in ensuring that relationships between the Fund and its members remained undisturbed. That was an important consideration as the Fund dealt with sovereign countries. In his view, therefore, there was hardly a case for changing the present rules.

If the Fund were to anticipate a sudden worsening of the situation, it could take action to meet such a contingency, Mr. Malhotra said. However, neither the staff nor management seemed to be expecting such an event. Consequently, he would prefer to maintain the present position.

Taking up the points mentioned by the staff. Mr. Malhotra said that he did not favor rigid timeframes, nor--for reasons explained by Mr. Polak--did he favor the levying of penalty charges. It was his belief that Fund members that fell behind in their payments did so for reasons that could be regarded as being beyond their control, rather than through recalcitrance. If any members were indeed seen to be recalcitrant, his chair would advise strong action, as he fully endorsed the principle that the Fund's credibility must be maintained, and that the Fund's financial position must be regarded not only by members but also by the markets as viable and strong. However, if penalty charges were levied on members that were unable to pay their normal dues, the Fund would be compounding the situation. If a member were unable to pay its normal obligation to the Fund, it might well be asked how it could pay penalty charges.

As to publicity, Mr. Malhotra said that he endorsed the view expressed by Mr. Polak, to the effect that, if a member had reached a position where it could not repay its obligations to the Fund, it would probably have lost its creditworthiness vis-à-vis commercial banks and other institutions or creditors. Nothing, therefore, would be gained by the Fund's bringing the matter to public attention. The only likely effect would be a deterioration in the relationship between the Fund and the member concerned.

Apart from communicating with the defaulting member and asking for due payment, Mr. Malhotra continued, management might after the lapse of three months send a mission to establish whether there was a genuine inability to pay for reasons beyond the member's control. If it transpired

that the nonpayment was due to recalcitrance, his chair would like to see the matter brought to the Executive Board as early as possible for appropriate action. If, on the other hand, the country was suffering from genuine hardship, the situation ought also to be brought to the notice of the Executive Board, so that it might be in a position to advise an appropriate course of action.

His chair would not like to encourage rescheduling of obligations to the Fund in the ordinary course, Mr. Malhotra remarked. Such a step should be exceptional. There were provisions in the Articles for postponing repurchases in exceptional cases, by a majority of 70 percent of the total voting power in the Board. He saw no reason why, if exceptional circumstances did exist in any case, the Executive Board should not postpone repurchases. The founders of the Fund had foreseen the possibility of countries' being overdue in their payments to the Fund for genuine reasons and had provided a remedy with adequate safeguards. The Fund should not debar itself from taking appropriate action if a country were to meet the requirements.

Finally, Mr. Malhotra pointed out, the world was passing through difficult times, and, as a result, countries found themselves in serious balance of payments problems. Therefore, unless matters were expected to grow considerably worse insofar as delay in repurchase was concerned, the Fund should not be seen taking action that was not compatible with the circumstances of the day.

Mr. Wicks remarked that there was little doubt that the vast majority of payments to the Fund from members, many of them in great difficulty, were made on the due date. On the other hand, there had been something of a deterioration in the number of payments that were being made at an overdue date. In 1977, 1.4 percent of payments as a percentage of total payments had been overdue for not more than two weeks, while the figure had steadily risen to 5.8 percent in 1983. That more than 1 out of every 20 payments was technically late was a serious matter, and he agreed with Mr. Polak. The fact that the present case did not involve large sums was not altogether relevant. What was involved was the principle of uniformity of treatment of members. It was not right to say that because a high percentage of members made their payments on time, it did not matter if a few members did not. If the Fund started to follow that principle, it seemed likely that over a period of time a rather large number of members would become late in their repurchases. It was also appropriate to consider the matter and to regularize the procedures; otherwise, circumstances could be envisaged in which, in a few years' time, the Fund might be faced with a much more difficult problem.

The fundamental principle was that obligations to the Fund must be discharged on the due dates, Mr. Wicks considered. Naturally, the Executive Board had the right, and sometimes the duty, to offer a member a waiver. Until the Board did so, however, the burden of ensuring that payments were made on the due date rested with the member. In that connection, he found it difficult to agree with some of the arguments put forward by Mr. Kafka.

He could not, for instance, follow him when he said that it was incumbent upon the Fund to investigate the presence of exceptional hardship, before taking decisions where such hardship might be relevant. That put the burden of proof on the wrong shoulders. The existing procedures, embodied in the Articles and the Rules and Regulations, gave members ample opportunity to demonstrate the presence of exceptional hardship. Until they did so, however, they ought to pay their obligations on time.

As Mr. Polak had explained, unless members had an assurance about the revolving character of the Fund's resources, there might be difficulty in replenishing them in the future, Mr. Wicks observed. Indeed, he would go further and argue that, since the essence of the Fund's cooperative character depended on members' providing resources, either through quotas or through lending to the benefit of members generally, for a member to take advantage of that cooperation by drawing on resources and then not repurchasing according to the schedule that had been agreed with the Executive Board was likely to undermine the Fund's nature, and, in the long run, to weaken its ability to help its members.

He was glad that the staff had not contemplated the postponement of repurchases other than very occasionally and after explicit approval by the Executive Board, Mr. Wicks stated. It was difficult to think of circumstances in which Executive Directors could contemplate postponement of repurchases, although of course it was always open to a member to try to demonstrate that it should profit from some such waiver. He was also pleased that the staff had not recommended that the Fund should automatically reschedule payments when other debt rescheduling took place. Agreement upon a Fund program was increasingly seen as the key that opened up official rescheduling by the Paris Club. It was therefore more appropriate for the Fund to contribute in that way toward the rescheduling efforts of others than to become involved in rescheduling of its own lending.

Taking up the suggestions put forward by the staff on page 17, Mr. Wicks stated that the Managing Director should normally initiate formal complaint procedures after a fixed period. Naturally, he should have the freedom of maneuver to make judgments in appropriate cases. To begin with, a formal complaint procedure could be initiated after a period of six months. He hoped that the introduction of such a procedure would cause a marked improvement in the settlement of all obligations. If it did not, it might be necessary to shorten the period after which the Managing Director would issue a formal complaint to three months, but he would not wish to do so at the present meeting. It would also be useful if Executive Directors could receive twice a year a report on the progress that was being made in eliminating overdue payments, perhaps by bringing up to date the tables contained in EBS/84/46.

On the question of penalty charges, his views were the same as those of Mr. Prowse, Mr. Wicks stated. He could agree that penalty charges might help in encouraging countries not to delay payments on technical grounds, and that they would be less helpful in cases where there was deliberate recalcitrance. The problem that he saw was in deciding into which category a particular late payment fell. On balance, like Mr. Prowse, he would prefer not to impose penalty charges.

Discussing the question of publicity, Mr. Wicks said that he understood the staff to be suggesting that publicity should be given to a case at the point when the Fund began to take steps to recover overdue payments. He himself believed that initiating publicity at that stage would be counter-productive. The member should be given the full advantage of the procedures provided in the Articles and the Rules and Regulations. However, once the procedures had been followed through and a member had been declared ineligible under Article XXIII or Article XXVI, or action had been taken under Rule K-2, it would be right for the Fund to make some formal announcement that action had indeed been taken. Finally, he would support the suggestion put forward by Mr. Erb and Mr. Polak that it would be worth establishing a formal performance criterion to the effect that should any payment to the Fund be overdue, the member would be ineligible to make any further drawings under any arrangement that it might have with the Fund.

Mr. Mtei remarked that there was general agreement that all members should remain current in their financial obligations to the Fund. A financially strong Fund was essential if the vital role assigned to it under the Articles of Agreement were to be fulfilled. It was in the interests of all members to ensure that members remained current in their payments so that the Fund should operate at full effectiveness.

Fortunately, Mr. Mtei went on, the staff seemed to show that performance to date in the matter of repurchases had not been bad. He agreed with Mr. Prowse's assessment that the Fund did not have an insurmountable problem on its hands. In the past five years, payments in Fund-related transactions with delays of more than two weeks had amounted to some 2 percent of the total. From 1981 through 1983, only two countries had been unable to meet their financial obligations to the Fund for periods in excess of 26 weeks. The Fund's performance as a debt collector had thus been remarkably good. Even the time spent on recovering payments was not very great compared with the amounts involved and the nature of lending by the Fund. After all, the Fund lent to countries in difficulties. The flexible procedures hitherto employed should therefore be continued.

The world was passing through difficult times, and it would be quite wrong of the Fund to expect to pass through such a period without encountering any difficulty in obtaining repayment from some of its members, Mr. Mtei considered. It seemed most unlikely that any country would deliberately decide not to discharge its financial obligations to the Fund when due. There were always compelling reasons behind delays in payments. Moreover, the reasons were mostly rooted in factors over which the member had no control.

It was easy to assume that a country was unable to meet its financial obligations merely because it had not taken the necessary adjustment measures, Mr. Mtei commented. However, that was not always so. Otherwise, there could be no rational explanation for countries meeting all the performance criteria under Fund programs and still finding it difficult to repurchase on due dates. In those cases, the most logical course of action would be to identify dispassionately the reasons for the inability

to repurchase. When it was found that the inability resulted from inadequate program design or the prevailing international economic and financial environment, the blame should not be placed entirely at the door of the debtor country. Instead, the Fund should try to find ways of alleviating rather than aggravating the situation.

Looked at in that light, Mr. Mtei went on, he was not certain that the staff proposals, including imposing a penalty charge and giving publicity to members' overdue payments, would lead to the desired results. Publicity would be counterproductive, as it would harm not only the potential recovery of the debtor country but also the Fund itself. Penalty charges on countries that could not even afford to pay in the absence of such charges would serve only to compound the problem and make more remote the chances of early settlement. Nor would the threat of expulsion recover from any member what was not available. Even a cow could be milked only if it was given some food.

While it was true that punitive steps were mentioned in the Articles of Agreement, they should be set in motion only if a member were found to be recalcitrant and indifferent to its obligations under the Articles, Mr. Mtei said. In genuine cases of hardship, the Executive Directors should seek to adopt measures that could lead to a positive result, including the possibility of invoking the provisions of Article V, Section 7(g) of the Articles of Agreement.

He did not find the staff's argument against invoking that provision at all convincing, Mr. Mtei stated. The Executive Directors should not appear to frustrate the clear intention of the founding fathers by being overselective in choosing to apply certain Articles, particularly if it were clear that it was impossible for a country to meet its repurchase obligations although it was prepared to cooperate with the Fund in finding appropriate solutions to its balance of payments problem. In that connection, a member might be required to initiate action under the Articles if it felt that it would suffer hardship by paying on the due date. The same reasoning applied to the provisions of Article V, Section 8(e) regarding the payment of charges in national currency to alleviate hardship. He endorsed Mr. Kafka's approach on that point.

In Mr. Malhotra's words, he would urge Executive Directors to appreciate that the world was passing through difficult times, Mr. Mtei commented. The forces at play, which made prompt repurchases impossible for a number of countries, were well known to the Executive Board and called for deeper understanding by the staff. He did not see what additional benefits would flow from new rules or further tightening of existing ones in the present circumstances. Rather, he would urge the Executive Board to agree to continue with the present rules and procedures, and with the flexibility that had been shown hitherto. However, should the staff perceive a worsening of the situation in the years ahead, it should not hesitate to submit status reports with recommendations on possible measures to be taken on a case-by-case basis. If it were discovered that a defaulting member was recalcitrant and had deliberately refused to meet its obligations when it could do so, his authorities would back strong measures against it in order to protect the interests of the Fund and the membership as a whole.

Mr. Laske recalled that in the course of the discussion for the Article IV consultation with a country that had had overdue payments to the Fund some weeks previously, he had made some general observations regarding the importance of members' discharging their payments on time. As to the seriousness of the problem, his thoughts ran much along the lines of those expressed by Mr. Polak, Mr. Erb, and Mr. Wicks. Delays beyond the due date were tolerable only when they lasted no more than a few days and were primarily caused by technical factors. It was extremely worrying that notifications regarding overdue payments obligations had become more frequent in recent times. To prevent such occurrences from becoming even more numerous, the Executive Board should urgently adopt more formal procedures, basically along the lines proposed by the staff.

As to the present policy with regard to overdue payments, he could endorse the course followed so far by management and staff, Mr. Laske stated. In particular, he could agree with the principle of not rescheduling repurchases from the Fund. If repurchase dates were set at the maximum permissible limit--five years from the date of purchase--the member concerned might well find itself in an extremely uncomfortable position. Naturally, when a country could convince the Fund that a very short-term postponement of a specific repurchase would enable its authorities to make the necessary payments, an exception might be acceptable. A proposal to that effect would of course have to be put forward by management, the duration would have to be very short, and the authorities' assurance of later repayment would have to engender a high degree of confidence. He would also support the continuation of the practice by which the Fund would not enter into negotiations on the use of its resources with a country that was overdue in its payments obligations. If such obligations became overdue after negotiations had been concluded, the request should be brought to the Executive Board only after the arrears had been eliminated. He supported the suggestion put forward by Mr. Nimatallah and other Executive Directors to include in future arrangements a standard clause indicating that disbursements would be stopped when repurchases or other payments obligations were not met on time by the country concerned.

While he would in principle support the proposal that the Managing Director should issue complaints under Rules K-1 and S-1 automatically not more than six months after the obligation became overdue, there ought to be some flexibility in application, Mr. Laske stated. If the member could prove in a convincing fashion that it would make payment in the immediate future--say, within the next week--it might not be necessary to take formal action.

The question of the imposition of a penalty rate was rather more difficult, Mr. Laske considered. On the one hand, if it were set high enough above market rates, it might act as an inducement to timely payment. On the other hand, the application of a sizable penalty might render a country's payments position even more difficult. Therefore, for the time being, he would not propose to take a decision on that topic but to give it more thought in the light of future developments. Nor would he like to decide at the present meeting on mandatory publicity for countries in

arrears to the Fund. Normally, the banking community and other lenders were well informed about a country's payments situation, so that public statements by the Fund would add little to what was already known. On the other hand, the possibility of such notifications, especially to a country's immediate creditors, might increase the hesitation to allow obligations to the Fund to become overdue. While he would not wish to see countries stigmatized, the matter should be taken up again if problems became more pressing.

Mr. Joyce remarked that the Executive Board was not faced by a crisis, and that it would be most damaging if anything that the Executive Board did at the present meeting, or if any of the decisions taken, were to give such an impression to the outside world. Nevertheless, the Board was facing a situation that had to be a matter of growing concern, and so far it was impossible to know whether the recent experience was a passing phenomenon or whether it was a harbinger of worse to come. He, like others, was deeply concerned about the increased incidence of overdue payments to the Fund, and he felt them to be a serious matter, not only for the Fund's role as a catalyst, but also for the impact that any major increase in overdue obligations could have on the revolving nature of the Fund's resources, and hence on the access of members to its assistance.

The Executive Board was clearly dealing with a sensitive matter that touched sovereign states in relation to their credit standing in the world at large, Mr. Joyce went on. The Board should therefore proceed with care, but it also needed to proceed with firmness. Circumstances did however differ in particular cases; hence Executive Directors should be prepared to take account of special circumstances on a case-by-case basis. Nevertheless, there should be clear procedures to ensure that when members did incur arrears, the situation would be considered by the Executive Board at an early date and that the Fund, on direction from the Board, would take action if necessary to protect its broader interests. Not only should the procedures be clearly known to all; the timing for the entry into force of the various stages should also be clearly set out.

Taking up the matters raised by the staff, Mr. Joyce said, first, that he agreed that the notification procedures followed by the staff hitherto should be continued. Recognizing that the procedures had placed an added administrative burden on the Treasurer's Department, it seemed reasonable that when arrears exceeded six months, the Managing Director should normally submit the case to the Executive Board, so that the Board could decide whether additional steps should be taken, possibly leading to a restriction of a member's rights to use the Fund's resources, or to ineligibility. Some flexibility would be required with regard to the action to be taken. More specifically, the Executive Board should be in a position to take into account any special circumstances in the member country. He did not support Mr. Nimatallah's proposals as he understood them, because they seemed to be rather rigid and mechanical. Nor did he support Mr. Erb's view that penalties should be automatic, and that the burden of proof should be on the country to demonstrate that the penalty should not apply in particular cases. The procedures outlined on pages 6 and 7 of EBS/84/46 struck a better balance between firmness and understanding.

He would not favor rescheduling or postponing obligations, Mr. Joyce continued. Rescheduling repurchases was unlikely to be helpful, except possibly in some exceptional cases. Rescheduling was tantamount to providing additional Fund resources to a member without an adjustment program and without performance criteria. When there was a case for the provision of additional resources, it should be considered in the normal way through discussion and negotiation of an arrangement with the Fund supported by an appropriate adjustment program.

The impact of publicizing a member's arrears might in many cases prove to be quite marginal, seeing that the member would in most cases have accumulated arrears elsewhere, and that its financial situation would be fairly well known, Mr. Joyce considered. Moreover, the publication by the Fund of information concerning the arrears of an individual country would threaten to breach the confidential arrangements that existed between the Fund and its members. It might therefore be best to use the publication only in those situations where the Executive Board had decided to limit a member's right to use Fund resources, or to declare a member ineligible.

He did not believe that penalty charges should be imposed, at least on relatively short-term arrears, Mr. Joyce stated. On long-term arrears, it was not clear that penalties would provide an incentive for reduction. He would however be interested to hear the staff view on how high a penalty rate would have to be in order to provide an incentive, and how the principle of uniform treatment would be applied if penalties were imposed on overdue charges.

He agreed that a member should not be able to make purchases under a Fund arrangement if it had not met its obligations to the Fund, Mr. Joyce commented. He would therefore support the adoption of a performance criterion in future Fund stand-by and extended arrangements that would prevent drawings under the program if a member incurred overdue payments.

On whether discussion of the use of Fund resources under a new arrangement should continue while arrears existed, Mr. Joyce said that he generally agreed with the practice being followed by management and staff. However, the application of that practice should be flexible. It made no sense to suspend, or not to engage in, negotiations in every instance when a country was in arrears. He agreed with Mr. Ismael and Mr. Senior that the Executive Board should not be too mechanical in its approach. It was necessary to distinguish between cases of inability to pay and cases of unwillingness to pay.

He was not sure that he would go quite so far as Mr. Mtei in dealing only with countries that were "recalcitrant," Mr. Joyce commented, because no member of the Fund would ever consider itself recalcitrant. Arrears of payments to the Fund always arose from economic circumstances that had affected members with unexpected force. Nevertheless, the situation ought to be looked at on a case-by-case basis if matters were brought to the Executive Board. It was also necessary to distinguish between cases where the arrears had been outstanding for a long time and where they were of

somewhat shorter origin. The Fund ought to make a careful examination in each case of the circumstances that would permit a country to obtain the resources necessary to discharge its obligations. Management ought to be able to authorize discussions when there was evidence that they could lead to the working out of an adjustment program that would satisfy other lenders of the willingness and ability of the authorities to confront their difficulties and to command additional financial support from the Fund. Only in those circumstances could a member obtain access to the additional resources that might well be needed if it were to repay its arrears to the Fund, or to demonstrate to Fund management that such financing was likely to be made available as soon as negotiations with the Fund had been completed. He would however agree that management should not authorize negotiations with a member if the obligations to the Fund had been overdue for an extended period. Finally, proposals for the use of Fund resources should not be considered by the Executive Board so long as there was no assurance that overdue obligations could be immediately discharged.

Mr. Lovato stated that he was in agreement both with the premises and with the principles set out in EBS/84/46. Specifically, he agreed with the staff that, although small in relation to total payments to the Fund and total Fund credit outstanding, delays in discharging obligations might undercut the efficiency of adjustment programs in the longer run. It was incumbent upon the Fund to safeguard the temporary and revolving character of its credit to members; and the credit standing of the Fund as a borrower ought to be protected, as mentioned by Mr. Nimatallah.

There was no doubt, as Mr. Kafka had maintained, that the accumulation of overdue obligations to the Fund was a manifestation of a more general external debt problem, Mr. Lovato considered. However, given the special role of the Fund in the international monetary system and the peculiar character of its traditional support for countries in the midst of adjusting their imbalances, as a matter of principle, obligations by members to the Fund should not be rescheduled. Overdue obligations to the Fund should be considered, therefore, in the context of the remedies being designed for debtor countries in general. He therefore endorsed the practice followed in the period after the Second Amendment of the Articles of Agreement.

He also agreed with the staff that rescheduling exercises with official creditors under the aegis of the Paris Club should not encompass debt owed to the Fund, which should continue to be repaid according to the Fund's own policies on the use of its resources, Mr. Lovato stated. He had no argument with the present practice regarding the criteria to be followed whenever a country with overdue payments made a request for Fund support or for further drawings under an existing arrangement with the Fund.

On the issue of fixed rules for initiating procedures against a country failing to fulfill its obligations to the Fund, Mr. Lovato said that, while only a short time should be allowed before initiating procedures, setting a fixed period would be a mistake. Cases of exceptional hardship might occur, as foreseen by Article V, Section 7(g), and the Fund ought to inquire into such instances in depth before taking a decision. Some flexibility

ought therefore to be retained, as had been argued by Mr. Kafka. Second, the imposition of penalty charges on overdue repurchases would only exacerbate a country's balance of payments difficulties and make prompt repayment less rather than more likely. As to publicity, he was inclined to think, like Mr. Kafka, that decisions should be taken by the Executive Board on a case-by-case basis. In general, he would be reluctant to allow any publicity, for the reasons given by the staff.

Mr. Hirao stated that although members had in general been prompt in meeting their financial obligations to the Fund, there had been a steep rise in the number of overdue payments. Like other Executive Directors, he was concerned about that development; it was pertinent to consider the matter at the present meeting. He fully endorsed the general approaches set out in EBS/84/46 for the reasons stated by Mr. Erb. Efforts should be made to eliminate the incidence of overdue payments, since they were contrary to the purposes of the Fund and impaired its smooth operation and credibility. It should also be noted that if payments of net charges imposed by the SDR Department continued to become overdue, they would raise doubts about the proper functioning of the Department.

As to whether a formal time limit ought to be laid down after which the Managing Director would normally submit a complaint under Rule K-1 or Rule S-1, Mr. Hirao remarked that it was reasonable that such procedures should take place after a relatively short period, such as six months from the date of repayment. The specification of such a time would help to ensure uniform treatment of members. However, the Fund should undertake further work before trying to decide whether there should be an automatic initiation of the procedures after six months. After all, the Executive Board might wish to exercise considerable discretion in dealing with individual cases. Moreover, the adoption of a fixed time period might have the effect of turning it into a grace period.

He would be prepared to support the introduction of penalty charges, Mr. Hirao stated. However, such charges could be imposed on a case-by-case basis, and only if they were considered to be effective in inducing prompt settlement of overdue obligations. The effectiveness of any such action should be weighed carefully in the light of the specific circumstances in each case.

Although the Fund ought to have the right to publicize cases of flagrant overdue payments, Mr. Hirao observed, he would prefer to take a cautious approach. As the staff had suggested, public awareness of a decision limiting a member's access to Fund resources, or a declaration that the member was ineligible, was likely to have a significant effect on any appraisal of a member's creditworthiness and thus influence the availability of foreign financing. In brief, publicity might increase the risk that it would become even more difficult to obtain settlement of an obligation to the Fund.

Mr. Schneider commented that in principle it was a matter of serious concern to all that in recent years failures by members to discharge their obligations to the Fund on time had increased. The staff had rightly

pointed out the negative repercussions that such developments could have for the Fund. On the other hand, the Fund ought to avoid adopting an approach to member countries with overdue payments that would leave them no room for maneuver. The proper course would be to adopt a balanced approach that would take due account of the interests both of the Fund and of the members concerned.

As to the suggestions by the staff, Mr. Schneider said that he was not much in favor of formalizing the present procedures; so doing would lose the flexibility that at present made it possible to take account of the special circumstances of countries in difficult situations. In other words, the Fund should continue with the case-by-case approach without fixing in advance any period for the automatic initiation of procedures. Executive Directors ought to keep in mind that the aim was to recover the resources that the Fund had made available to members; for that purpose, flexibility was needed. For the same reasons, he had doubts about the establishment of penalty charges; he did not believe that they would be at all helpful in recovering the Fund's resources. On the question of publicity, in principle the Fund should limit the distribution of information on overdue payments to the membership at large. Going further would not only damage the credit standing of the member country concerned; it might also have negative repercussions on the standing of the Fund.

In brief, Mr. Schneider stated, he favored continuing the present practices on a case-by-case basis. That procedure offered the best chance of members' eventually repaying the Fund. However, in order to preserve the integrity of the Fund and the revolving character of its resources, the Fund should not wait long before initiating the procedures set out in the Articles and in the Rules and Regulations.

Mr. Tshishimbi commented that the increase in the number of failures by member countries to discharge their obligations to the Fund on time--deplorable as it was--was a symptom of the external debt problems that the Fund had been trying hard, in conjunction with the commercial banks and other lending institutions, to overcome. The debt crisis had been exacerbated by two interconnected factors, namely, a depressed world economic environment and the impact of the recession on borrowing countries, compounded by other domestic economic difficulties in those countries. The prime concern must be to preserve the revolving character of the Fund's resources and, beyond that, the credibility of the Fund as a financial institution.

The staff had been correct, Mr. Tshishimbi considered, in distinguishing between delays in payment for technical reasons and those that reflected shortages of foreign exchange and serious balance of payments difficulties. Most delays fell into the first category. To deal with them, the Fund had for a long time been refining its repurchase policies and improving its administrative techniques, including the provision of technical assistance when necessary. Only two difficult cases out of almost 50 members using the Fund's resources were outstanding in the second category, and the staff had given an assurance that the amounts involved were small in relation to the Fund's overall lending operations.

To bring about further improvements in the administration of the Fund's financial operations, the staff had proposed the adoption of a period of, say, six months, after which procedures would be undertaken automatically, Mr. Tshishimbi noted. Such a change would however be likely to result in a substantial reduction of the flexibility that staff and management had exercised successfully in the past, and should therefore be resisted. There was a risk that the six-month period might be considered a grace period. As to the imposition of a penalty charge, he agreed with the staff that for such a penalty to constitute a real deterrent, the rate of charge would have to be so great that it would further aggravate the member's balance of payments difficulties, rather than improve them. The imposition of a penalty charge would be tantamount to suspecting the country of a deliberate unwillingness to pay when it was able to do so. Nor did he believe that publicizing the actions of the Fund vis-à-vis the member would be helpful. Such publicity could only impair the member's creditworthiness and render more difficult its access to foreign financing.

As to the question of postponing repurchases, Mr. Tshishimbi remarked that a postponement within the repurchase period was likely to result in ballooning the obligations at the end of the period, thus merely displacing the member's difficulties to a later date. Moreover, the difficulties would only have been increased unless an adjustment had taken place to enable the member to meet its obligations. One way to overcome that difficulty would be to use the possibilities provided in the Articles of Agreement. While it would not be appropriate to associate the postponement of repurchases to the Fund with any multilateral rescheduling exercises, in circumstances of exceptional hardship, Article V, Section 7(g) would allow the Executive Board to postpone repurchases to longer than the normal period.

In brief, Mr. Tshishimbi considered, the current procedures had served the Fund well. Many payments delays had so far been settled on a case-by-case basis, and it was his chair's view that the same procedures should be continued. In so stating, he stressed the importance of keeping lines of communication open with member countries. Members that needed to negotiate an arrangement with the Fund to support an adjustment program should not be denied that right simply because payments to the Fund were overdue, especially in the circumstances of hardship that he had mentioned. While he could agree that the burden of establishing the case for hardship should lie with the member, the Fund had a special obligation to maintain communications with the country. Consequently, even if a country's payments to the Fund had become overdue, the proper procedure would be to try to convince the country to adopt an adjustment program that would allow it to repay the Fund, instead of forcing it to wait until it could find resources elsewhere with which to repay.

Mr. Tvedt said that he endorsed the staff's approach to the problem of overdue payments to the Fund as described in EBS/84/46. A rise in overdue payments was bound to erode the Fund's credibility in the eyes both of its debtors and of its creditors. If continued, the present trend would also lead to great uncertainty in the management of the Fund's liquidity,

and it might eventually damage the Fund's basic standing as a source of balance of payments financing, and thus in the longer run have negative effects on the overall activity of the institution. The increasing number of delays in payment could in no way be blamed on the Fund, which had developed a variety of advance warning systems to facilitate timely payment.

Commenting on the remedies proposed by the staff, Mr. Tvedt said that he supported the present policy of not allowing further access to Fund resources if a member were in arrears to the Fund. He also welcomed Mr. Nimatallah's proposal to add a performance criterion to stand-by and extended arrangements, by which purchases would be conditional on a member's being current in its payments to the Fund. Moreover, he had no difficulty in accepting the staff's proposal for formalizing the Managing Director's complaints under Rule K-1 and Rule S-1. The idea of establishing a policy on the imposition of proposed penalty charges seemed reasonable. Giving more publicity to the procedures with respect to overdue obligations was also worth considering, although publicity might, as mentioned by Mr. Ismael and others, prove to be a double-edged sword. Finally, he was rather skeptical of the notion of rescheduling repurchases.

Mr. Blandin commented that the failure to pay obligations to the Fund on time was a very serious matter. His chair agreed that the Fund's credibility and its financial position had to be preserved. The basic principle that obligations to the Fund had to be discharged on due time should be reaffirmed. Nevertheless, in particular cases it was clear that problems could arise. In those circumstances, while the rules should be clear and uniform, they should not be excessively rigid; if they were, they could disturb the relationships between the Fund and its members. In specific cases, excessively rigid procedures might be a less than satisfactory way of tackling the problem.

Taking up the specific suggestions made by the staff in EBS/84/46, Mr. Blandin said that he could accept a proposal that there should be a fixed period after which the Managing Director would normally submit a complaint under Rule K-1 or Rule S-1, provided that considerable emphasis was placed on the word "normally." In other words, the procedure should be applied with the necessary flexibility. Moreover, the period should be sufficiently long to give the member enough time to meet its obligations. Six months seemed a reasonable period. Penalty charges could only help if the delays were due to technical reasons. In other circumstances, penalties might only be counterproductive and worsen the situation. He was therefore rather opposed to the suggestion for instituting penalty charges. As to publicity, publicizing a member's failure to make payments on time at an early stage was also likely to be counterproductive and might well have negative effects on the Fund itself. It did not seem appropriate to him for the Fund to involve the media in such matters, even if at a later stage publicity might be considered on a case-by-case basis. As to the rescheduling of repurchase obligations, he agreed with paragraph 5 on page 15 of EBS/84/46, meaning that he did not believe that the Fund should reschedule repurchase obligations, even if a member had engaged in such negotiations with the Paris Club or other groups.

Mr. Finaish remarked that overdue payments still constituted only a small proportion of total payments to the Fund, both in amount and in frequency. It was however important that the upward trend of the past few years should be reversed, especially the longer delays that could be quite detrimental not only to the countries concerned but also to the membership as a whole. The recent steps described by the staff on page 5 of EBS/85/46, aimed at helping members to avoid payment delays, should be useful. In that connection, he wondered whether consideration had been given to providing countries with projections of charges on a routine basis instead of on request. Aside from those administrative steps, a reduction in difficulties due to debt, including the incidence of overdue payments to the Fund, would clearly depend on an improvement in the economic environment currently facing a large number of countries.

Taking up the procedures described by the staff in EBS/84/46, Mr. Finaish remarked that while a case could be made for instituting a fixed period before adopting procedures leading to a limitation of a member's right to use Fund resources, the outcome might be that a complaint by the Managing Director under Rule K or Rule S was issued despite firm expectations that repayment would soon be made. Perhaps more important, a flexible period would allow the Fund to draw a distinction between cases where the delay was caused by genuine hardship, and those where the ability to repay was not in question. It might therefore be desirable to leave some flexibility to management, perhaps with the understanding that procedures would not be initiated before six months, and that, in the absence of strong indications that repayment was forthcoming, the period would not exceed a reasonable outer limit, unless of course the Executive Board decided to postpone the overdue repurchase.

He agreed with the staff and other Executive Directors, Mr. Finaish went on, that publicizing the initiation of procedures might be counterproductive, as so doing might make it more difficult for the country to discharge its obligations to the Fund. In taking the necessary steps to expedite repayment, it was important that the Fund should not be seen either as insensitive to the legitimate difficulties of members, or as using its catalytic role to add to their difficulties. It did not seem appropriate, therefore, for the Fund to establish a general rule publicizing its proceedings against members on grounds that their repayments were overdue.

The present practice of not submitting to the Executive Board requests for the use of Fund resources to members whose payments were overdue seemed appropriate, Mr. Finaish observed. However, it was less clear to him that it was a good idea automatically to interrupt discussions with the authorities on such requests when payments became overdue. In many cases, those discussions could be useful in identifying policies and measures that would help the member to deal with the payments imbalances that had given rise to arrears in the first instance. Naturally, the Fund should make it clear to the member that its request could not be considered before all obligations were discharged.

As to imposing penalties on overdue repurchases, Mr. Finaish noted that many speakers and the staff had made a case against imposing such charges, which might well be self-defeating. It was however for consideration whether the administrative costs associated with the delays in repayment should continue to be distributed among all users of Fund resources, or whether those costs should be borne only by members whose repayment obligations had become overdue. The issue was not one of penalty but of apportionment. Since the amounts were relatively small, such an arrangement should not lead to any aggravation of a country's payments difficulty, as a penalty charge probably would.

Mr. Zhang commented that, since delays in payments were only a small part of total payments to the Fund and of Fund credit outstanding, and since the delays were often linked directly to the present unfavorable world economic conditions, he saw no great urgency for changing the present procedures.

As to the three questions suggested by the staff for consideration, Mr. Zhang remarked that insofar as possible, the Fund should avoid establishing a relatively short fixed period after which the Managing Director would normally submit a complaint under Rule K-1 or Rule S-1. If a country were already in a difficult position, such action by the Fund would clearly not make it more able to pay. Second, he agreed with the staff that the imposition of a penalty charge on overdue payments would be harmful. Third, the Fund should in principle try to avoid publicizing any action that it might take if a country became overdue in its payments.

The Fund should certainly not try to expel a member from the organization for allowing its repayments to become overdue, Mr. Zhang commented. On the other hand, it should consider the possibility of rescheduling the repayment of debts by members to itself.

Mr. Teijeiro said that he was firmly convinced that it was in the interests of the international financial community that the Fund should promote and maintain a strong financial position. One of the basic ingredients in the accomplishment of that aim was the timely repurchase of obligations by users of Fund credit. The short-term nature of Fund financial assistance, and the revolving character of its resources, left no doubt of the need for member countries to fulfill their repayment obligations in accordance with the existing rules. It was indeed worrying to see that there had been a growing tendency for the number of overdue repayments to the Fund to increase. On the other hand, long delays had occurred only in exceptional circumstances, so that the Executive Directors would not face a situation in which the credibility of the Fund's programs or the confidence of its creditors could be hampered or eroded.

While there was no doubt that Executive Directors should spare no effort to preserve the financial health of the Fund, Mr. Teijeiro went on, the current procedures remained valid for the time being, and an increase in sanctions in the form of penalty charges or publicity would not preclude members from allowing their payments to become overdue for financial reasons.

Both penalty charges and publicity might only lead to an exacerbation of the problems. Moreover, the present procedures contained sufficient flexibility at both management and Executive Board levels, without jeopardizing the principle of uniformity of treatment.

Finally, Mr. Teijeiro said that he agreed that rescheduling of repayments to the Fund in parallel with rescheduling that might be arranged with other creditors was out of the question. However, the alternatives provided by the Articles of Agreement should be considered, particularly when the adoption of a satisfactory adjustment program could help to improve the prospects for repayment.

Mr. Salehkhou noted that the Executive Board had before it in a single meeting a paper on experience and procedures with overdue payments to the Fund and the consideration of the cases of two member countries with such overdue payments. He would have liked the policy paper to be considered separately at another session, so as to prevent any possibility of the discussion's being influenced by the case of Guyana and the somewhat politically sensitive case of Nicaragua.

More specifically, Mr. Salehkhou went on, his chair did not dispute the financial principles on which the Fund was founded, which had been derived from the Articles of Agreement and the Rules and Regulations, together with decisions by the Executive Board and Resolutions by the Board of Governors. He had therefore no difficulty in reaffirming the principle that the Fund's resources were revolving in character and for temporary use only. Moreover, as an Executive Director of the Fund, he had a vested interest in safeguarding the credibility of the institution and the creditworthiness of member countries. The last thing a sovereign member of the Fund would wish to do would be to jeopardize its financial credibility by not giving the highest priority to any obligations to an international financial institution such as the Fund, assuming that the necessary financial resources were available.

In recognizing that the principles were valid, Mr. Salehkhou remarked that the Fund had no reason to believe that they had not been observed, at least insofar as could be seen from an inspection of the tables in EBS/84/46. While it was true that the number of overdue payments had increased, Table 3 might lead to the conclusion that the payments overdue for more than six weeks--and those were the ones that had concerned Directors--had not increased as fast as shorter arrears. The number seemed to lie between three and five, and the amounts involved were not significant if compared with the increase in the Fund's lending operations. Naturally, he was not implying that the Fund should not make every effort to recover any amounts owed to it. However, the procedures followed so far had given good results, and it was clear to him that the Directors should allow the staff and management sufficient flexibility to deal with such problems on a case-by-case basis.

The Fund should avoid any rigid rules, Mr. Salehkhou maintained, such as the imposition of penalties or the publication of cases of overdue payments. After a reasonable period, the staff should report to the Executive

Board on cases of overdue payments and offer some judgment as to why the members had not met their obligations. If members showed an unwillingness to pay and yet had the means to do so, he would agree that the harshest measures should be applied. If, on the other hand, the failure to pay were caused by events beyond the control of the authorities, the Fund should be understanding and avoid any extreme measures that might not be compatible with the functioning of a major financial institution, and could thus prove counterproductive to the aims of the Fund. Naturally, he would be prepared to review the matter in detail if the number of cases increased substantially, or if the amounts involved became so large as to impair the normal functioning of the Fund.

Mr. Nimatallah said that whether having clear rules and procedures laid out in advance would be helpful to management and the Executive Board was a matter of judgment. His own view was that, not only in the medium term but in the long run, having clearly stated rules and procedures would be helpful to the Fund, and he did not believe that such an arrangement would lead to confrontations with members. On the contrary, the members would surely be happy to know exactly what the procedures would be. Nor did he believe that members would consider the periods before action was taken by the Fund to be grace periods that could be used as an excuse for inaction. Establishing clear rules and procedures at the present time would surely not give the wrong message to members. What it would do would be to say that the Fund remained strong, and that it was clear in its own mind about what ought to be done in the few cases when repayment was unduly delayed.

Similarly, Mr. Nimatallah went on, whether the problem had reached such proportions as to become serious was also a matter of judgment. Clearly, two different aspects were at stake: the matter of principle and the statistical problem. On the matter of principle, there seemed to be no dispute that all members were concerned that repayments should be made on time. The Fund's resources were for the use of all, and they should be available, to the greatest extent possible, whenever needed. Naturally, if unfortunate circumstances prevented a few members from making repayment on time, they should be given an opportunity to show that the circumstances were so severe that the late payment was beyond their control. Nevertheless, he was convinced that it was better for the Fund to take action forthwith, rather than to allow the problem to become statistically significant. In principle the problem was already serious; it might become statistically serious unless action were taken.

Another area of judgment was that of publicity, Mr. Nimatallah considered. Naturally, the appropriate action would depend on the nature of the case. He could agree with Mr. Malhotra that it might be useful to send a mission to see whether the country whose payments were overdue was willing to pay but unable to do so for reasons of hardship, or whether it was showing recalcitrance. Clearly, if it were a matter of hardship, the Fund should show understanding and allow any current negotiations to continue. However, it was just possible that there might be a case of recalcitrance, and for those circumstances the Fund should have clear rules.

If the Fund intended to maintain the principle of uniform treatment, it was clear that no single member should have the right to take advantage of the Fund's resources for a long period when they were needed by others, Mr. Nimatallah observed. As to whether having clear rules necessarily implied rigidity, he did not believe so. Flexibility should be shown until it was evident that the member did not intend to take action to repay. At that point, without abandoning the principle of uniform treatment, it would be helpful for the Fund to give publicity to the case. It should simply announce that the member did not intend to take steps to reduce its arrears to the Fund. Such an announcement was bound to have a fairly strong effect, and the fact that the announcement would be made should be understood in advance by any member likely to be in such a situation. It was particularly important that members should understand that if negotiations failed to provide a solution, in the end the Fund would have no alternative but to make the position public. Clearly, the objective was to underpin the strength of the Fund, to reaffirm the principle of uniform treatment, and to assert the principle of the revolving character of the Fund's resources. Naturally, the Fund should remain flexible in its attitude to members, but in the end there should be no misunderstanding: it would remain firm.

Mr. Malhotra, replying to a comment by Mr. Nimatallah, explained that the position of his chair was that, if any member were judged to be recalcitrant, the situation would have to be viewed seriously. The point he had been making was that a judgment whether a member was recalcitrant should be reached by the Executive Board after thorough discussion by the staff and management with the country concerned. The Rules already provided quite clearly what action could be taken in those circumstances. Indeed, he was going further and suggesting that if recalcitrance were established, it would be desirable, even without a formal complaint, to bring the matter to the notice of the Executive Board for discussion as early as possible. In such a case, he would have no difficulty in reducing the limit below the six months suggested. On the other hand, setting a rigid date might cause difficulties in cases of genuine hardship.

Mr. Nimatallah stated that he preferred to have clear rules in advance and waive them when necessary, rather than wait until the Fund was faced with a position in which it might not know how to act, thus possibly prejudicing the rights of the member.

Mr. Kafka commented that in his opening remarks he had been guided by the idea that it was essential for the Fund to try to resolve difficult situations without exacerbating them. He therefore adhered to his original position on such matters as fixed time periods, penalty charges, and publicity. He had found interesting the idea put forward by Mr. Wicks and Mr. Mtei that the Fund should circulate six-monthly progress reports on the position of overdue obligations. As to the question of proof of hardship, he could agree with Mr. Wicks that he should have said that it was incumbent upon the Fund to "consider" the presence of exceptional hardship rather than to "investigate" the presence of exceptional hardship, which was the word that he had used earlier.

As to whether the Fund should cease to negotiate with a country whose payments to the Fund became overdue, Mr. Kafka considered that such a proposal would put a country in an impossible situation: it would not be practical to demand that the country repay the Fund in a reasonable period when it could do so only by borrowing if, in order to borrow, it had to have an arrangement with the Fund. He had serious doubts whether the rule about not negotiating with a country whose obligations were overdue was really helpful to the Fund. He had liked Mr. Malhotra's suggestion that when an overdue obligation emerged, the Fund should send a mission to the member concerned. Naturally, the whole mission would have to be handled with tact in order to avoid embarrassing authorities who were doing their best to pay meanwhile. He also thought useful Mr. Finaish's suggestion that the Fund should regularly supply countries with projections of their forthcoming payments. While theoretically it ought not to be necessary, in practice it might well save considerable difficulty.

The Treasurer observed that from his standpoint any overdue payment to the Fund was a serious matter because it implied that obligations had not been fulfilled. The structure of the Fund rested on the confidence of the whole membership that individual members would collaborate in the way set out in the Articles of Agreement. The Fund could not go to court to collect payments due to it, nor could it fall back on the seizure of securities. In brief, the entire operation of the Fund rested on the fulfillment of obligations by members.

As to the seriousness of delays by members in settling obligations, the Treasurer remarked that the incidence of overdue payments had risen considerably in the past few years. The explanations for the rise had been given by the staff in EBS/84/46.

While it might be admitted that technical weaknesses could prevent timely payments in all cases, the Treasurer explained, he had felt that if a delay lasted more than about two weeks, more than technical or administrative reasons were involved. Delays of two weeks or more had risen from 0.5 percent of all payments in 1977 to 2.2 percent in 1982 and 1.3 percent in 1983. In commercial banking, delays in 1 percent or 2 percent of payments would lead to a consideration of the need for a higher spread, or of the establishment of higher reserves to cover the growing risk of nonpayment.

The containment of the number of instances of overdue payments was largely attributable to the procedures that had been fully described in EBS/84/46, the Treasurer continued. There could be no doubt that in several instances the initiation of the procedures had shortened the time during which the arrears had been outstanding. In that connection, it might be interesting to note that one proposal on which some Directors had expressed doubts--namely, the proposal that the Fund should not negotiate with a member whose payments had become overdue--had been one of the most effective instruments in persuading members to settle their overdue payments. The adoption of such a stand as a performance criterion would certainly strengthen the hands of the Fund.

On the statistical side, the Treasurer remarked that 17 countries out of 46 that had had credit arrangements with the Fund in 1983 had been late in one way or another in settling payments to the Fund. It could not therefore be said that only a very small number of payments were overdue in proportion to the amounts outstanding. A question of uniformity of treatment certainly did arise because the figures did show that a substantial number of members did not settle their obligations to the Fund promptly while others did, often with great difficulty.

Regarding the establishment of penalty rates, the Treasurer recalled, one Executive Director had asked how high a penalty rate would have to be to make it effective. The staff itself was of two minds as to whether a penalty rate would be useful, but it was worth recalling that central banks did impose extra charges on commercial banks if they did not make their repayments on time, and the extra charges often had a biting effect. Commercial banks raised their charges by 1 percent or 2 percent above the current rate, depending on the severity of the case. Even the fiscal authorities, at least in the United States, imposed a penalty charge for late payment without accepting any excuses. Such a procedure might, however, not offer useful guidance for the course of action that the Fund would adopt. One suggestion had been made that the Fund should recover the cost to the membership at large, a procedure that would enforce the principle of the revolving character of the Fund's resources, while not being so large as to cause an excessive burden on members paying late. Another proposal had been that the Fund should eliminate the subsidy that was implied in the interest rate set for the use of its ordinary resources. Such a proposal did of course leave open the question of what consideration should be given to the interest rate on borrowed resources. A suggestion had been made that the penalty rate for members that did not repay their obligations after a given period of time should be raised to one point above the market rate. The question of how long that period of time should be was of course to be discussed. In any event, the staff had not made any proposals regarding penalty rates.

One speaker had put forward the idea that the staff should routinely provide members with information about their forthcoming payments to the Fund, the Treasurer noted. Such information was not routinely provided to all members, because most of them were aware of their financial obligations to the Fund. On the other hand, the staff had frequently given information to members in difficulty and smaller members requiring technical assistance from the Fund in managing external indebtedness. The same information for that group of members was provided to Fund missions, so that there was already some duplication of effort. Furthermore, members that did not have sufficient SDRs with which to pay charges were routinely provided with proportions of charges well before they fell due. Finally, the staff could without difficulty prepare a half-yearly status report on overdue payments.

The Chairman then summed up the discussion so far in the following words:

Principles

First, the Executive Board considers the existence of overdue payments to be a serious matter, which touches the very nature of the Fund's fabric. It affects the revolving character of the Fund's resources and the monetary nature of the institution; it clearly has an impact on the Fund's liquidity and may well impair its credibility if matters were allowed to drift. It could thus jeopardize the standing of the Fund and the willingness of its members to reconstitute its resources if they felt that there is some doubt on the liquid character of the assets that they are building up in the institution. It could therefore undermine the effectiveness of the Fund and prevent it from performing its extremely important catalytic and financial roles.

Second, the existence of overdue payments is also obviously related to the question of the evenhanded treatment of Fund members. The overwhelming majority of members do pay on time, often with great pain and sacrifice. In those circumstances, why should a very few members, which do not have greater difficulties than the bulk of the other countries, be left in a position where they can impose the consequences of their inaction on the rest of the membership?

Third, the existence of overdue payments touches on the cooperative nature of the Fund. For its success, such an institution requires all members--creditors and debtors alike--to abide by the rules. Members that have incurred obligations to the institution must discharge them on time. This is an overriding principle that no one has contested, and that we should strongly reaffirm.

This is not a crisis; the number of extended delays is still limited, and the actions of the Board and the daily efforts of the staff have helped considerably to keep the situation under firm control. It is true that in terms of percentages of payments, the delays of two weeks and more have not increased over the past three years; in fact, they were smaller in 1983 than in earlier years. Nevertheless, the number of overdue payments has been tending to rise, and the 5.8 percent figure for last year does represent a deterioration since 1981.

In sum, we do need to remain extremely vigilant in ensuring the timely discharge of financial obligations of members to the Fund, and we must make it clear that this institution reaffirms the overriding need to safeguard its credibility. This reaffirmation is all the more important because many other financial

institutions are having to face a deterioration in the quality of some of their assets and to accept some interference with their normal procedures. It is essential that the Fund, which has not in any way been a cause of the problem, should maintain an impeccable record and that there should be no shadow of doubt about its financial standing.

Without fundamentally changing our procedures, which have rendered good service to the institution and have kept the situation under control, we should identify them more clearly, ensure that they are better understood by the membership, and make them more systematic, which does not mean making them inflexible. Executive Directors clearly wish the rules to be clear, and to be well known to all members. The Fund should take advantage of a relatively calm situation to adopt precautionary actions designed to prevent any further deterioration, so that we shall not be obliged to act in a much more forceful way under the pressure of circumstances.

Procedures

The sense of the meeting is to approve the approach suggested by the staff in EBS/84/46, and I shall only mention a few major points that have been the subject of discussion.

1. Period for complaint

The Executive Board was clear that the period for initiating the formal procedures under Rule K-1 or Rule S-1 should be relatively short, say, on the order of six months. However, it also showed that it did not wish to be too mechanistic on this point, allowing management some degree of flexibility.

2. Penalty charges

The discussion showed that while the Board considered that it might be helpful to resort to penalty charges, especially in cases where the delays are of a technical nature--the effect would be to encourage countries to overcome administrative problems--many Directors were doubtful whether, if the delays were relatively long and the situation more difficult, the existence of penalty charges would do anything more than compound the problem. I do not detect a sense of the meeting in favor of immediate action on penalty charges; but I do think that we should come back to the question if the situation justifies doing so. I was interested to note Executive Directors' suggestions for ways in which penalty charges should be used and, in particular, for ways of recouping at least the costs for the membership at large stemming from delays. The staff will undertake further work on that point.

3. Publicity

The Executive Board said clearly this morning that it does not want publicity, at least in the early stages. But it was also quite clear that Directors felt that once procedures have been initiated by the Executive Board and management, there might be a case for some formal indication at least to the membership and perhaps to others as well that we have reached a certain point. At the same time, there was a rather strong feeling that the Fund should try to avoid having these matters appear in the media. It was felt that such publicity could be harmful not only to a member's efforts to meet its obligations to the Fund, but also to the Fund itself, especially in its relationship with the country concerned. We should therefore not engage in any systematic publicity. The Executive Board could take a decision in particular cases on an ad hoc basis.

4. Rescheduling or postponement of obligations

The position described in paragraphs 5 and 6 on page 16 of EBS/84/46 was supported by the majority of the Executive Board. The Executive Board clearly does not wish to open the way for rescheduling of obligations. The staff arguments on the point were clearly found convincing and were supported by the Board. This does not mean that the relevant Articles, particularly Article V, Section 7(g), cannot be resorted to in exceptional cases if the Board so decides. But while the Board would have to satisfy itself that discharge on the due date would result in exceptional hardship, the burden of proof that such hardship would result must be on the country, and I did not sense much support in the Board for the use of this provision. There is a strong sentiment against the idea that the Fund should match the rescheduling operations of the Paris Club or any other group, and it is useful that the Board was so clear on this point. The Fund could certainly not adopt such a course.

5. Relations with members while payments are overdue

The Executive Board unanimously reaffirmed the existing practices described in paragraph 7 on page 17 of EBS/84/46. This means that management will not submit to the Board any requests for the use of Fund resources under a stand-by or extended arrangement as long as the member concerned has overdue payments to the Fund.

There was more debate whether the Fund should engage in discussions or resume discussions on the use of Fund resources with a member that is in arrears to the Fund. On the whole, the practice of not entering into discussion in those circumstances was confirmed. A number of speakers expressed strong views on this point. But the practice of refusing to hold

discussions with members with overdue payments has been effective. If the situation is fairly calm just now, it is in part because we have held to this rather firm line. The rule that a country cannot enter into discussions on the use of Fund resources while it has arrears to the Fund is a strong incentive for the country to pay its debts, and I would be cautious in changing the present policy. We are trying to strengthen this policy, not weaken it.

This does not mean that we are not going to continue discussions. In the past few months we have continued discussions with members with overdue payments; but the discussions were confined quite precisely to assisting the members to organize their affairs in order to permit the payment of the overdue obligations. The discussions did of course entail consideration of the adjustment measures that would make it possible to repay, and which could possibly be supported later by a program. Far from cutting our lines of communication, we should do what we can to keep them open. But we should direct the discussions toward enabling the country to make repayments.

Suggestions by Directors

I would have no difficulty with asking the staff to prepare six-monthly reports on overdue obligations.

The sense of the meeting was that we should make a formal performance criterion out of the requirement that no purchases may be made under a program if obligations are overdue. This was the view of the Board, and we shall propose some formal wording to the Board to incorporate it as a performance criterion in the standard arrangement. This is preferable to the present practice by which we sometimes ask countries to confirm in writing that they will not ask for purchases if they have overdue obligations.

Sending a mission if obligations remain unpaid beyond a certain time may not be desirable in all cases--it depends very much on the sort of communications we have with a country--but in some cases it may well be helpful.

The staff can certainly include a record of a country's past performance of financial obligations to the Fund in papers on the use of Fund resources.

When the area departments draw up a program with a country, they should emphasize to member countries not only the overriding importance of making these payments, but also the need to fit them into the country's overall external obligations. We should insist more on the need to take account of the profile of their indebtedness to the Fund in framing their external policy and

stress measures that the authorities should take in advance to be sure that they can repay a certain amount to the Fund on a given date. When we know that reserves are very low and that the situation is probably going to be difficult, we should help countries to draw up a timetable as a way of avoiding difficulties at the time of repayment.

2. GUYANA - OVERDUE FINANCIAL OBLIGATIONS TO FUND - REPORT AND COMPLAINT UNDER RULE K-1

The Executive Directors considered a staff paper entitled "Guyana - Overdue Financial Obligations to the Fund" and a communication from the Managing Director, entitled "Guyana - Report and Complaints Under Rule K-1 and Rule S-1" (EBS/84/47, 3/9/84; Sup. 1, 4/2/84; and Sup. 2, 4/4/84), together with a proposed decision.

Mr. Kafka made the following statement:

It must obviously be our rule to treat all members equally. There are three prima facie precedents for the action that we are now contemplating. They refer to Cuba, the United Arab Republic, and Kampuchea. I am not convinced that the first and last are applicable precedents. There were special circumstances concerning Cuba. In any case, the K-1 report, as distinct from a simple notice, was not sent until more than a year after an obligation had become overdue, and no decision was taken until 15 months after the obligation had become overdue. Kampuchea, on the other hand, has been, as it were, internationally incommunicado for many years, except for participation in certain UN activities. It is also, therefore, hardly a precedent. In this case, moreover, complaints under K-1 (and S-1) were circulated, but only informally, and nearly four years after an obligation became overdue. In the one case that can be considered a precedent, that of the United Arab Republic, no K-1 notice was given, and no K-1 report was made.

There is no question that Guyana has delayed its payments and that action must be taken by the Fund to safeguard its interests. This is true although Guyana is undoubtedly one of the most--perhaps the most--grievously harmed country by the oil price increase, because 23 percent of its GDP is today spent on oil imports, as against 5 percent before 1973. Thus, Guyana is certainly an exceptional hardship case.

The proposal I would make to the Board is a provisional one. I would propose that we request the Managing Director to communicate at the highest level with Guyana and convey to them the seriousness of the situation that has arisen between Guyana and the Fund. I would propose, in addition, that the Managing Director should communicate to Guyana that, unless an adequate

adjustment program is adopted in a reasonable period, further action would unavoidably follow on the part of the Fund. But, I would also propose either that provisionally the Fund should postpone repurchases and accept the payment of charges in Guyanese dollars--which would, of course, have to be repurchased--or that it should withhold action for a limited time.

I would hope that, by such action and additional action, an unnecessary dilemma would be avoided. The additional steps that I am proposing are entirely in line with present Fund practice. We would, in the normal way, dispatch to Guyana, not of course a negotiating mission, but an Article IV consultation mission, which would have to take place within a few months anyway. The mission would describe to Guyana, after conducting the consultation, the specifics of an acceptable program. And it would inform potential lenders of any action taken by Guyana, unless Guyana objected.

Unless the steps that I have indicated are taken, it is almost inconceivable that Guyana would find a lender to advance the resources that it would need to pay the Fund. It has so far been unable to do so. On the other hand, the amounts involved are large enough in relation to Guyana's GDP, i.e., close to 3 percent (including repurchases, and over 1 percent for charges) that it would be impossible for Guyana to pay in the short run out of its own earnings, which might also be attached by other creditors. On the other hand, Guyana's delay so far in coming to an agreement with the IMF has not been capricious, but has resulted from the need to take fundamental decisions, with an all-encompassing impact, concerning the basic export industry, bauxite. I believe that conditions for a decision on this basic problem are now ripe. Finally, I would note that Guyana has settled its obligations to the SDR Department.

The Treasurer confirmed that Guyana had paid its arrears to the SDR Department. Consequently, the Managing Director no longer had any complaint against Guyana in that Department. The language of both the Managing Director's complaint and the proposed decision had therefore been amended; the correct language was set out in EBS/84/47, Supplement 2.

Mr. Kafka suggested that there might be further communication between the Managing Director and authorities in Guyana before the Executive Board took the proposed decision. The outcome might be more satisfactory from the standpoint of the Fund.

Mr. Nimatallah and Mr. Malhotra supported Mr. Kafka's suggestion.

Mr. Wicks observed that it might be more helpful to the Guyanese authorities if the Executive Board took the proposed decision at the present meeting, inserting a rather distant date for the meeting of the Executive

Board at which the complaint would actually be heard. If, meanwhile, the Managing Director were in contact with the Guyanese authorities and the answer were not entirely satisfactory, the situation would be less embarrassing both for the Guyanese authorities and for the Executive Board than if Mr. Kafka's proposal were adopted.

The Director of the Legal Department noted that the decision to be taken at the present meeting would do no more than set a date of a Board meeting to consider the action to be taken and to invite Guyana to send representatives to attend that meeting. The substantive discussion would not take place until the date of that meeting.

The staff representative from the Western Hemisphere Department, replying to a question by Mr. Joyce, explained that the Guyanese authorities were fully aware of the procedure. The staff had been in discussion with them about the problem for nearly a year, since the time when overdue payments had first appeared. On the most recent occasion, the staff had made it absolutely clear to the authorities that, according to the established rules in the Fund, the staff could no longer continue discussing with them the use of Fund resources as long as the financial obligations of Guyana to the Fund remained outstanding.

Mr. Kafka added that he had explained the position in detail to both the Governor and the Alternate Governor of the Fund for Guyana in recent days. In the meantime, Guyana had made a considerable effort and had paid its charges due to the SDR Department. The authorities were making efforts to repay, but they might find it difficult to do so.

Mr. Laske stated that he would prefer to follow Mr. Wicks's suggestion. As he understood it, the decision would do no more than invite the country to send a representative to put its case before the Executive Board; in taking the decision at the present meeting, the Board could deliberately leave time for Guyana to make an additional effort to discharge its outstanding obligations.

Mr. Zhang considered that, for the sake of consistency, it might be better to postpone taking the decision until the Managing Director had held the suggested further communications with the authorities in Guyana.

The Director of the Legal Department, replying to a question by Mr. Tshishimbi, explained that if the Guyanese authorities succeeded in paying off their obligations to the Fund, the Managing Director would report to the Executive Board that the payments had been made, and that no further complaint would be needed.

Mr. Tshishimbi remarked that in the circumstances, it would be best to postpone taking the decision until the Managing Director had had his further communication with Guyana.

Mr. Joyce commented that, in view of Mr. Kakfa's explanations, he would be inclined to allow the Guyanese authorities some leeway. One way of dealing with the matter might be to postpone taking either of the two

decisions on the agenda until after the meeting of the Interim Committee. That would enable the Managing Director or the staff to undertake whatever communications might be considered suitable. If that course were followed, however, he hoped that any discussions would not be based upon the specific proposals put forward by Mr. Kafka. They involved a form of rescheduling of Guyana's obligations to the Fund, and it seemed quite clear from the earlier general discussion that the Executive Board did not wish to follow such a course. As he saw it, the purpose of the communication between the Managing Director and the authorities in Guyana would be to ascertain whether the authorities anticipated that they could meet their obligations in the very near future, thus obviating the need for the application of any procedure; or, at the least, that they would be quite aware of the procedures that were about to be applied to them. In brief, he would suggest postponing discussion of the complaints against Guyana and Nicaragua until after the Interim Committee meeting. At that time, the Executive Directors could decide on the date on which they wished the representatives of the two countries to appear.

Mr. Mtei considered that, in view of Mr. Kafka's remarks, there might be some merit in postponing taking a decision until after the Managing Director had communicated with the authorities in Guyana. Clearly, there was no evidence that the Managing Director's communication would resolve matters; if it did not, the Executive Board would pick up the topic again at the time suggested by Mr. Joyce.

Mr. Kafka said that he would be grateful if Mr. Joyce's proposal could be accepted. A communication between the Managing Director and the authorities in Guyana might lead to the initiation of procedures by which Guyana might find sufficient credit to repay the Fund. Such a communication would be entirely in accordance with the Managing Director's summing up on the general topic, according to which the Fund could continue discussions of adjustment measures even with members having overdue obligations.

Mr. Senior and Mr. Finaish commented that it would be helpful to follow Mr. Joyce's proposal and return to the matter after the meeting of the Interim Committee.

Mr. Prowse remarked that the general discussion on overdue payments had led to certain conclusions that ought, surely, to guide the action by Executive Directors in individual cases. The proposal by Mr. Joyce seemed to him to move away from the conclusions reached earlier. Mr. Wicks had put forward a suggestion in a clear attempt to meet the particular problems mentioned by Mr. Kafka in connection with communication with the Guyanese authorities. The risk of not acting in accordance with that suggestion seemed to present more difficulties both for the Fund and for Guyana than doing so. He therefore preferred Mr. Wicks's suggestion to the latest proposal by Mr. Joyce and others.

The Chairman commented that the Executive Board clearly had before it two possible courses of action. The first was for the Executive Board to note the complaint by the Managing Director and to invite the Guyanese

authorities to discuss their case at a later stage. Meanwhile, he as Managing Director would be invited to be in touch with the authorities to see whether it was possible for them to improve their adjustment policies and clarify the possibility of their making the overdue payments. The date for the authorities to make their case to the Executive Board could be put fairly far forward, as suggested by Mr. Wicks. One month would probably be the minimum time needed. The second possible course of action would be not to take a decision at the present meeting, to invite the Managing Director to communicate with the authorities, and to return to the topic after the meeting of the Interim Committee.

Mr. Kafka suggested that if the Executive Directors selected the first course mentioned by the Chairman, it would be better to insert a date eight weeks hence rather than four weeks.

The Executive Directors thereupon approved the first proposal put forward by the Chairman with the insertion of the date of Wednesday, June 6, 1984 as the time when the Guyanese authorities could make their case before the Executive Board.

The decision was:

1. The complaint of the Managing Director dated April 4, 1984 on Guyana, in EBS/84/47, Supplement 2, is noted. The complaint shall be placed on the agenda of the Executive Board for June 6, 1984.

2. Consideration of the complaint in accordance with Rule K-1 particularly affects Guyana. The member shall be informed by rapid means of communication of this matter and of its right to present its views through an appropriately authorized representative.

Decision No. 7660-(84/54), adopted
April 5, 1984

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/84/53 (4/4/84) and EBM/84/54 (4/5/84).

3. APPROVAL OF MINUTES

The minutes of Executive Board Meetings 83/166 through 83/169 are approved. (EBD/84/104, 3/29/84).

Adopted April 4, 1984

4. EXECUTIVE BOARD TRAVEL

Travel by Executive Directors as set forth in EBAP/84/67 (4/3/84) is approved.

APPROVED: May 24, 1984

LEO VAN HOUTVEN
Secretary

Honorable Carl Greenidge
Governor of the International
Monetary Fund for Guyana
Ministry of Economic Planning
and Finance
Georgetown, Guyana

I refer to the various communications of the International Monetary Fund to you concerning the nonobservance of obligations under the Articles of Agreement of the Fund.

I attach for your information the text of my memorandum of April 4, 1984 to the Executive Board setting forth the obligations under the Articles of Agreement of the International Monetary Fund that it appears to me are not being observed by Guyana.

The Executive Board has decided to place on its agenda for a meeting to be held on June 6, 1984 the complaint set forth in paragraph 2 of my memorandum.

Consideration of the complaint in paragraph 2 of my memorandum could result in the declaration of ineligibility of Guyana to use the general resources of the Fund under Article XXVI, Section 2(a) of the Articles of Agreement, or the limitation of Guyana's use of the general resources of the Fund according to Rule K-2 of the Fund's Rules and Regulations.

The Government of Guyana is entitled under the Articles and By-Laws of the Fund, and is therefore invited, to present its views, both orally and in writing, through an appropriately authorized representative at the meeting of the Executive Board referred to above, and at such subsequent meetings as the Executive Board may hold on this matter, at the Fund's headquarters in Washington, D.C. If you so desire, the Executive Director elected by Guyana may represent Guyana at any such meetings.

I am prepared to make arrangements at your request for the full briefing of your representative on all relevant matters.

J. de Larosière
Managing Director
Interfund

Please repeat to:

The Honorable
Patrick E. Matthews, Governor
Bank of Guyana
Georgetown, Guyana

Attachment

April 4, 1984

To: Members of the Executive Board

From: The Managing Director

Subject: Guyana - Report and Complaint under Rule K-1

1. Repeated communications have been addressed by the International Monetary Fund to Guyana, and repeated contacts have taken place with the Guyanese authorities concerning the nonobservance of certain obligations under the Articles of Agreement of the Fund. The communications and contacts have not resulted in a resumption of the observance of such obligations.

2. The following complaint is made in accordance with Rule K-1 of the Fund's Rules and Regulations. It appears to me that Guyana is not fulfilling obligations under the Articles of Agreement relating to repurchases and charges in the General Department. As of March 30, 1984 these obligations were as follows:

(a) To repurchase the equivalent of SDR 8,492,188, including

(i) repurchases equivalent to SDR 3,281,250, due in installments of SDR 2,187,500 on May 31, 1983, and of SDR 1,093,750 on July 30, 1983, in respect of a purchase made on July 31, 1978, under the compensatory financing facility, and

(ii) repurchases equivalent to SDR 2,156,250, due in equal installments of SDR 1,078,125 on June 27 and December 27, 1983, in respect of a purchase made on June 28, 1978, under the extended Fund facility, supplementary financing facility, and

(iii) repurchases equivalent to SDR 2,343,750, due in equal installments of SDR 781,250 each on July 16, October 16, 1983, and January 16, 1984, in respect of a purchase made on January 17, 1980 under the compensatory financing facility, and

(iv) a repurchase equivalent to SDR 710,938, due on February 5, 1984 in respect of a purchase on August 6, 1980, under the extended Fund facility, supplementary financing facility; and

(b) To pay charges of SDR 5,499,206, of which SDR 1,505,295 was due on July 13, 1983, SDR 756,007 was due on August 4, 1983, SDR 744,084 was due on November 8, 1983, SDR 1,761,460 was due on January 12, 1984, and SDR 732,360 was due on February 7, 1984, under Article V, Section 8(b).