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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 01/84

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Executive Board Attendance

	E. Aninat, Acting Chairman
Executive Directors	Alternate Executive Directors
S.M. Al-Turki	A.S. Alosaimi
	J.G. Borpujari, Temporary
	T.-M. Kudiwu, Temporary
	P. Charleton
	P.H. Whitehall, Temporary
M.J. Callaghan	N.J. Davidson, Temporary
	S. Bonomo, Temporary
	S. Urinbaev, Temporary
	R. von Kleist
	F. Haupt, Temporary
	D. Lombardi, Temporary
	C.A.E. Sdrlevich, Temporary
	Low K.M.
	T. May, Temporary
V.L. Kelkar	R.A. Jayatissa
W. Kiekens	J. Prader
	I. Abel, Temporary
O.-P. Lehmussaari	S. Kropas, Temporary
	T. Elkjaer, Temporary
R. Quarles	J.W. Ralyea, III, Temporary
P. Duquesne	G. Bauche
	B. Couillault, Temporary
	S. Rouai, Temporary
	J.K. Kwakye, Temporary
	A. Lushin
	Y. Lissovolik, Temporary
	M. Beauregard, Temporary
	S.P. Collins
	M. Walsh, Temporary
M. Portugal	A. Rambarran, Temporary
C.D.R. Rustomjee	I. Usman
	T. Belay, Temporary
A.S. Shaalan	S.A. Bakhache, Temporary
	N.H. Farhan, Temporary
Wei Benhua	Jin Qi
	Liu Z., Temporary
J. de Beaufort Wijnholds	Y.G. Yakusha
	E. Azoulay, Temporary
	H. Toyama
	M. Yanase, Temporary
	N. Watanabe, Temporary
	R. Maino, Temporary
	D. Vogel, Temporary
	S.J. Anjaria, Secretary
	A. Linde, Acting Secretary
	Z. Ahmed, Assistant
	S. Djumena, Assistant
	T. Davidson, Assistant

Also Present

IBRD: J. Wilton, Credit Risk Department; I. Andersen, A. DePlaa, Resource Mobilization Department. African Department: B. Akitoby, D. Coe, J. Gons. European I Department: G. Bell, J. Escolano, L. Everaert, B. Horvath, C. Kollau, A. Leipold, M. Louppe. External Relations Department: J. Wolff. Legal Department: H. Elizalde, I. Mouysset. Policy Development and Review Department: M. Allen, Deputy Director; L. Dicks-Mireaux, L. Ebrill, M. Fetherston, S. Kashiwagi, M. Plant. Secretary's Department: S. Bhatia, P. Ramlogan. Treasurer's Department: M.G. Kuhn, Deputy Treasurer; B.S. Newman, Deputy Treasurer; B. Christensen, F. Diallo, J. Lin, Y.F. Lum, D.J. Ordoobadi. Western Hemisphere Department: C. Francis, A.M. Jul. Office of the Managing Director: A. Bauer, T. Diamond, R.S. Teja. Advisors to Executive Directors: M.P. Bhatta, A. Kapteyn, Liu F., J. Mafarikwa, J. Milton, H.E. Phang, M. Yépez. Assistants to Executive Directors: A. Alber, S. Alcaide, V. Bhaskar, P.A. Brukoff, C. Josz, B. Kelmanson, P. Lathouly, S. Le Gal, K.S. Oo, B. Siegenthaler, J. Sipko, E.S. Weisman, I. Zakharchenkov.

1. EXECUTIVE DIRECTORS

The Acting Chairman welcomed Mr. Bischofberger as Executive Director for Germany, Mr. Duquesne as Executive Director for France, and Mr. Quarles as Executive Director for the United States.

2. OVERDUE FINANCIAL OBLIGATIONS—STRENGTHENED COOPERATIVE STRATEGY—REVIEW; EXTENSION OF RIGHTS APPROACH; PROCEDURES APPLICABLE TO PRGF TRUST; AMENDMENT TO PROCEDURES FOR DEALING WITH MEMBERS IN ARREARS; POLICY TO PUBLISH INFORMATION ON MISSED REPURCHASE EXPECTATIONS; AND AMENDED DECISIONS

The Executive Directors considered a staff paper reviewing the Fund's strategy on overdue financial obligations to the Fund (EBS/01/122, 7/23/01).

The staff submitted the following statement:

As highlighted in the Board review of the overdue financial obligations by the Democratic Republic of the Congo (DRC) to the Fund on July 13, 2001, close coordination between the Fund and the Bank is essential to address the administrative, economic, and debt problems facing post-conflict countries in arrears to the Fund, the Bank and others. The Acting Chairman's Summing Up of points related to the review of the DRC's overdue financial obligations is as follows:

“Directors continue to attach the highest importance to members with overdue financial obligations making timely repayments to the Fund. However, they recognized that in the present special circumstances of the DRC, direct payment to the Fund to reduce arrears could conflict with the World Bank's policies governing access to IDA grants. Against this background, Directors recognized the reasons for the authorities having taken the course of making monthly deposits equivalent to SDR 100,000 into an account with the Bank for International Settlements (BIS). They welcomed the strong commitment of the DRC authorities to work toward a comprehensive arrears clearance program.

Given these circumstances, Directors agreed, on an exceptional basis, to accept the DRC's deposits with the BIS in lieu of immediate payments to the Fund. They also agreed that this ad-hoc arrangement could be revisited after the upcoming Annual Review of the Fund's Strategy on Overdue Financial Obligations; that it does not prejudice the outcome of that review; and that it does not set any precedent for the handling of overdue obligations in the case of other countries with different circumstances. Directors encouraged the staff to consult with IDA staff with a view to improving consistency between the policies of the two institutions.”

On July 31, the World Bank Board approved a US\$50 million grant from IDA to the DRC to support an emergency early recovery project, including technical assistance. The grant is expected to be fully disbursed by end-July 2003. The grant was authorized under a framework for IDA grants approved by Bank's Executive Directors in connection with the DRC approval on July 31, 2001.

The Fund and the Bank have a policy of collaborating closely on efforts to assist members with arrears to one or both institutions in becoming current promptly. During the pre-arrears clearance stage and respecting the principle of comparable treatment, both institutions expect members in arrears to make payments, as appropriate, taking into account the members' specific circumstances, particularly their payment capacity.

Both institutions also act in the spirit of mutual support when one of the institutions is confronted with arrears, as such arrears constitute a major challenge to the cooperative nature of the institutions. In the case of countries with arrears to both institutions, the preferred approach is that arrears to both are cleared simultaneously. However, and in close consultation, sequential clearance may be considered on a case-by-case basis. The aim is to resume financial assistance from both institutions to the member that has cleared arrears as quickly as possible. Experience with these policies has been satisfactory.

The Fund and the Bank also play complementary roles in helping post-conflict countries in arrears achieve economic recovery. Consistent with its character as a monetary institution with revolving resources, the Fund would typically continue to initiate the recovery process by addressing macroeconomic imbalances through staff-monitored programs or, for eligible countries, rights accumulation programs. The implementation of suitable policies and the initiation of payments to stabilize or reduce the pace of further arrears accumulation to the Fund will continue to be important tests of cooperation.

In post-conflict cases, the Fund would determine flexibly the level of payments to the Fund to reduce arrears accumulation, taking full account of the country's payment capacity. The Fund, in consultation with the Bank, would also be prepared to continue to initiate lending to countries that did not have arrears to the Fund notwithstanding the presence of arrears to the Bank. Such flexibility is necessary to enable the Fund to continue to play its role in the initial stabilization effort, even while arrears are being cleared to the Bank and other international financial institutions.

The World Bank recognizes the Fund's role in promoting the macroeconomic underpinnings for any recovery effort by requesting that a post-conflict country with arrears to the Fund and the Bank be cooperating

with the Fund before the Bank would consider exceptional grant financing to assist the country in recovery and arrears clearance. The new Bank policy on the extension of IDA grants to post-conflict countries during the pre-arrears clearance period is not intended to alter the requirement that the recipient countries be cooperating with the Fund. The conditions on the extension of IDA grants in this situation are intended to ensure that the exceptional resources provided will be used for the purpose of meeting the countries' initial critical recovery needs through positive flows to post-conflict countries as soon as performance warrants.

Bank staff also recognizes the importance of establishing a payment track record and agree that in the majority of cases regular procedures for establishing such a track record are satisfactory. They are of the view that, under the framework established by the Bank's Executive Directors for IDA grants, the number of cases that could qualify for such grants will be limited. In these circumstances, they note that payment of any debt service obligations, even small amounts, to any creditor would be inconsistent with the intention of the IDA policy governing the extension of grants to post-conflict countries prior to arrears clearance. On this basis, they believe that a modified approach to establishing a payment track record should be adopted in these few cases. Specifically, they support an approach whereby payments to the Fund and other multilateral creditors, including the Bank, to establish a payments track record prior to arrears clearance would be made into a specified reserve account in the borrower's name, and whereby transfers from that account to the respective creditors would occur at the time of arrears clearance.

In the case of the DRC, the Fund has agreed on an exceptional basis to accept the DRC's deposits with the BIS instead of immediate payments to the Fund, subject to subsequent review by the Executive Board. The SDR 100,000 per month deposits being made by the DRC are only 10 percent of the amount needed to stabilize arrears and one-sixth of the amount originally agreed by the DRC authorities and the staff mission that negotiated the staff-monitored program (SMP) discussed by the Executive Board on July 13, 2001. These deposits are being made to an account held by the DRC pending a decision by the Executive Board whether to request the DRC to transfer all or some of the amounts held in the account and make subsequent direct payments to the Fund. Staff propose that this decision be taken no sooner than the next review of the DRC's arrears to the Fund scheduled for mid-January 2002 and no later than the completion of the staff-monitored program scheduled for March 2002. A decision on the size of any follow-on PRGF arrangement from the Fund would take account of the DRC's balance of payments needs. Reflecting comparable treatment, it is likely that the World Bank and the African Development Bank would request the transfer of amounts accumulated in their accounts by the DRC at the BIS at the monthly rate of SDR 60,000 and SDR 70,000, respectively, at the same time as the Fund.

In conclusion, a difference remains between Bank and Fund staff on when the DRC authorities should be requested to transfer accumulating funds to the institutions. This difference appears to reflect a different policy emphasis by the respective Executive Boards. As noted in paragraph 8 above, Bank staff state that any direct payments by the DRC to the Bank (and to the Fund and other creditors) prior to arrears clearance are inconsistent with the intention of IDA policy. Fund staff attaches importance to the principle consistently applied by the Board to date that actual payments by the member to the Fund to reduce arrears accumulation are important as a demonstration of cooperation.

Staff recommends that the Fund retain the flexibility provided under the arrears strategy to determine the amount of payments to the Fund as a test of cooperation rather than adopt a policy of no payments for countries receiving IDA grants. In the case of the DRC, a request that the DRC transfer resources from the BIS account could be deferred in order to provide an opportunity to assess the DRC's performance on policies under the SMP, deposits to the BIS account, and progress in the arrears clearance process. The Fund would consider further a possible request for transfer at the time of the next review of the DRC's overdue financial obligations to the Fund, which is currently scheduled for mid-January 2002. Fund and Bank staff will continue their close collaboration on addressing the needs of post-conflict arrears countries on a case-by-case approach that is consistent with their respective financial structures and facilities, and arrears clearance policies.

Mr. Shaalan and Mr. Bakhache submitted the following statement:

While overdue obligations to the Fund have declined marginally in the year ending April 2001, there has been a noteworthy and unfortunate development, namely the emergence of Zimbabwe as the first country with protracted arrears to the PRGF-Trust and the first new case with significant arrears to the GRA since 1997. Notwithstanding these mixed developments, our overall impression, however, is that the Fund's strategy on overdue financial obligations continues to work well. In fact, since 1991, as the number of countries with financial obligations falling due to the Fund has increased from 146 to 164, the number of countries with late payments has significantly declined from 45 to 26 members. This is an improvement of over 40 percent in the repayment record of our member countries. However, the data indicate that there is an increasing concentration of arrears in the Fund. Balanced against this consideration, as the staff report points out, is the significant progress that continues to be made in improving relations with Sudan, the largest arrears case to the Fund. This is a clear indication that our strategy on overdue obligations has been working and is serving all Fund members well. In particular, both the prevention and the intensified collaboration aspects of the strategy, the most important elements in our view, have been delivering their intended positive results.

Moving forward, the focus of the Fund's efforts should remain on prevention and intensified collaboration, and we support the extension of the availability of the rights approach through end-August 2002. Regarding the conditionality and terms of the RAPs, we believe that an accurate illustration of a typical RAP should reflect the practice followed so far. In particular, while Box 1 of the report points out that a RAP is generally of a three-year duration, it continues to say that the average length of the three RAPs (for Peru, Sierra Leone, and Zambia) was around two years. This implies that RAPs are generally of a two-year duration not three years as mentioned in the Box.

On the occasion of the discussion of de-escalation of remedial measures under the strengthened cooperative strategy in 1999, the issue of payments to the Fund was stressed as an indispensable element of the Fund's arrears strategy. While we continue to believe that the amount of payments should be determined flexibly taking into account the country's capacity to repay, this decision should be made independently by the Fund without third-party influences. In dealing with the case of the Democratic Republic of Congo, which is admittedly complicated given the important role of IDA in the country, it is essential that this principle be maintained. We should avoid creating precedents that could potentially trigger similar action by other donors further complicating the task of normalizing relations between the Fund and countries with protracted arrears. Equality of treatment, a pillar in the Fund's relations with its members, should also not be compromised.

Moving to the issue of strengthened procedures on PRGF arrears, we can go along with the proposed measures, but have a comment on the proposal to consider removing a member country from the list of PRGF-eligible countries after its arrears have been outstanding for six months. This measure seems redundant particularly given that the country's access to PRGF and HIPC Initiative resources would have already been suspended, and it creates an unnecessary step in the process of normalizing relations with the Fund.

Regarding publication of information on arrears, it is unclear what the policy of "enhanced transparency" is intended to achieve in the context of the Fund's strategy on overdue financial obligations. The emergence of arrears to the Fund is a very serious matter with potentially severe implications for the country involved and the whole membership. However, at the early stages of the emergence of arrears, we feel it is best to maintain the current policy of dealing with the issue internally and directly with the concerned member. Making public information on a country's arrears, particularly at an early stage, does not seem conducive to resolving the problem and may in fact create unnecessary publicity on an issue that may otherwise be resolved shortly afterward. In any case, as footnote 20 of the report indicates, the information on overdue financial obligations can be detected using the information already provided on the Fund's external web site in the month

following their occurrence. Do we want to engage further in the name and shame philosophy? With respect to publishing information on missed repurchase expectations, it is important that expectations be treated as such and, as we emphasized during the discussion on this issue, failure to meet them should not be handled as a breach of obligations that call for the proposed publicity.

Mr. Kelkar submitted the following statement:

We wish to thank staff for a well-focused paper and welcome this discussion on the Fund's strategy on overdue financial obligations of the Fund. This review is timely in the context of the recent discussion on Zimbabwe. Our views on the proposed decisions are given below.

We note that the obligations from the three countries, which are eligible for the Rights Accumulation Program, form about 80 percent of the Fund's protracted overdue payments. We therefore support the proposal for extension of the rights approach through end-August 2002. However, it does not appear to us that, apart from Sudan, the other two countries can benefit from this extension. In the case of Somalia, it has been separately proposed to postpone the review by six months, due to the lack of a basis to assess its cooperation with the Fund. A weakening of policy implementation, and deterioration of relations with external creditors has been noticed in the case of Liberia, and staff suggests that an escalation of remedial measures may have to be considered in November. Clearly, neither country may be in a position to enter the RAP by August next year. Does this imply that we will face an extension decision yet again next year? Would it be possible to develop a viable alternative to this? What about a country, which is not eligible for the rights approach?

We are in broad support of the proposed procedures outlined for addressing overdue financial resources from the PRGF Trust, as this seeks to parallel the procedures already established for GRA and SDR resources. However, we have misgivings on two issues. Firstly, we are not sure as to the need for clause 7, which permits removal of a member from the list of PRGF eligible countries if its obligations are overdue for more than six months. This move appears unnecessary, as the member's access to Fund resources would have been suspended at the time of the emergence of the arrears itself. Further, inclusion of such criteria in the PRGF eligibility parameters, which basically have a poverty focus; does not appear appropriate. We are equally uncomfortable with the explicit provision for suspension of Technical Assistance to such a country. Technical Assistance is one of the elements of the first pillar of Fund's strengthened cooperative strategy, and it should be used to strategically engage a country that is seen as "not contributing adequately to the resolution of its problems," rather than denying it and thus aggravating its exclusion.

We are also less sanguine about the need to amend the current policy on overdue financial obligations, and shorten the period after which information on arrears will be published, from six months to three months. This will be at variance with the existing policy of reporting only those obligations in the Funds financial statements, which are overdue for more than six months. Staff point out that this proposed change will be consistent with the Fund's move towards enhanced transparency and careful observers can already deduce such conclusions from available information. Even if this were the case, we feel that the advantages to be gained by compressing the period to three months may not outweigh the disadvantages that would accrue to the affected country as a result of what may be seen as premature publication. Despite staff assertions to the contrary, we are not very sure that the initial three-month period will be sufficient to resolve those arrears, which are temporary and technical in nature. This additional period, outside the glare of adverse publicity, may be useful to the country to regularize its position. Those countries which are now in protracted arrears to the Fund, saw their initial arrears emerging between five and seventeen years ago. Three months is a relatively short period when compared to such a time frame. Staff point out that the proposed practice will be consistent with the International Accounting Standards, but could this be because it espouses a more conservative view, rather than because of any other intrinsic merit?

We are uncomfortable with the staff proposal for publication of the fact of missed repurchase expectations beyond three months in the relevant country page of the Fund web site. Given that members are expected to meet repurchase expectations only if their external position had been stronger than had been projected at the time of approval of the arrangement—mentioning the fact of their failure to meet these expectations will not only affect their standing with other organizations but also affect private sector sentiment. The fact that the policy on repurchase is available in the country web page, under a layer of hyperlinking, may not provide adequate consolation. In this context, since repurchase expectations which have been met as well those which have been extended are to be publicized on the respective country pages in the external website, is it necessary to be symmetric and publicize repurchase expectations in the web pages of those countries which have not met them? Would this not anyway be deducible by elimination without the need to specify it?

We support the proposed decision on updating the reference in the PRGF Trust instrument.

In regard to the payments made by the Democratic Republic of Congo to the BIS, we support the staff position that payments made by a member to the Fund to reduce accumulation of arrears are an important demonstration of cooperation in the arrears strategy. In the case of the DRC, we agree that the

issue of transfer of funds could be considered at the time of the next review of DRC's financial obligations.

Mr. Wijnholds and Mr. Azoulay submitted the following statement:

We would like to thank the staff for the concise and interesting document. We attach importance to a clear, transparent policy on a member's incurrence of arrears toward the Fund. We support the continuation of the rights approach, which gives members with arrears the opportunity to establish a track record and subsequently to clear their arrears.

When coming to review the Fund's strategy on overdue obligations, the most important issue is to assess the effectiveness of the current strategy. More specifically, we must determine the effectiveness of our strategy in resolving current arrears cases and preventing new ones. Table 6 in the staff document shows that protracted arrears cases totaled 11 in the first half of the 1990s, dropping to 6–7 by 1996 and remaining stable at this level through 2001. It seems then that the strengthened cooperative strategy initiated in 1990 in response to mounting concerns about rising arrears proved quite successful in the first half of the 1990s. It not only prevented an increase in arrears cases, it also helped reduce the number substantially. However, the number of arrears cases remained stable in the second half of the 1990s. The strategy was thus effective in preventing new cases, but not in markedly reducing the number of existing cases. We recognize that two of the remaining six countries could not be approached due to special circumstances. Nonetheless, there was no progress in the other cases, particularly that of Sudan, which accounts for half of total arrears to the Fund. Thus, the strategy's prevention component—which includes surveillance of members' economic policies, successful implementation (and follow-up) of IMF-programs and technical assistance—seems to be adequate. However, the other components of the strategy that deal with resolving current arrears cases need to be modified. To this end, we suggest that we consider, in the next review, ways to modify our strategy to make it more effective in resolving current arrear cases. The proposed decision on publication of information on arrears, brought to us for today's discussion, seems designed more to strengthen prevention than to reorient the strategy to facilitate the resolution of current arrears cases.

Table 6 also gives information on members with late payments to the Fund. In designing the Fund's strategy on overdue obligations, it is quite sensible to distinguish protracted arrears from late payments due to technical or other reasons. The number of late payment cases is substantial. Even though communications have improved substantially throughout world, we have seen no parallel reduction in the number of late payments. Members incurring late payments totaled 21 in 1995, 31 in 1999, and 20 in 2001. We would be interested in seeing a breakdown of these cases in terms of the length of lateness and the specific technical or temporary cause of lateness.

We should identify members with recurring late payments and examine Fund measures to address technical problems affecting timeliness to achieve a marked reduction in late payments. While this review deals extensively with publication of information on arrears, we suggest that the Board also consider publication of information on late payments by releasing the relevant data on the web page of the concerned country.

In the same vein, the document under discussion does not put forth any proposal regarding the continuing phenomenon of overdue currency valuation adjustment obligations. At end-April 2001, 15 members had overdue CVA obligations amounting to SDR 2.7 billion. The document indicates that in many cases, delays in settling CVA obligations stem from a lack of domestic legal or administrative procedures and sometimes from a member's inadequate understanding of its responsibility for settling its obligations. These issues can easily be taken up with the concerned member country as part of the Fund's regular surveillance or when discussing the conditionality of a new program. When needed, technical assistance should be provided to help the country establish the necessary legal framework and to support its capacity to resolve this type of overdue obligation. Again, on this issue, we support publication of information on the concerned country's web page.

Turning now to the specific issues under consideration.

On payments to the Fund in arrears cases, while we believe that payments constitute an important part of establishing a track record of cooperation with the Fund, we believe that any inconsistency between Fund and World Bank policies should be resolved between these institutions. Agreeing with Messrs. Pickford and Bauche, we believe that a general policy solution is needed. The DRC in this respect should not be trapped in the middle. We welcome the supplement issued by staff on this topic, reinforcing the Fund's continued close collaboration with other IFIs on addressing the needs of post-conflict arrears countries. Like the staff, we believe that flexibility in dealing with arrears on a case-by-case basis is justified. Although the DRC's case will be reviewed at length early next year, our initial inclination is to favor giving priority to the reconstruction and stabilization efforts made by all IFIs and the donor community to help the DRC at its current juncture. Furthermore, postponing the transfer of the BIS-account proceeds would not constitute a major disruption of the Fund's policy on arrears, as DRC's transfers to the BIS-account are monitored by and earmarked for the IMF.

On PRGF arrears, we support the recommendations to strengthen procedures in cases solely involving overdue obligations to the PRGF Trust.

On publication of information on overdue financial obligations, we support the proposed new policy, which is more in line with the Fund's enhanced transparency.

On publication of information on missed repurchase expectations, we would prefer publication of this fact in the country's Article IV report; or even publication of a short ad hoc note on the non-compliance with a repurchase expectation. We would expect that the publication would include the member's reasons as to why the repurchase expectation was not met.

Lastly, we support the publication of the staff paper under discussion.

Mr. Rustomjee submitted the following statement:

I welcome this review and staff suggestions for further strengthening the Fund's Arrears' Strategy. I concur that the first line of defense is prevention of arrears, and this is feasible if countries adhere to prudent economic policies while the Fund strengthens its surveillance activities. Experience so far reveals that countries fall into arrears for varied reasons; conflicts, international sanctions, adverse economic shocks, technical and methodological differences with Fund staff, and sometimes poor policies, among other reasons. It is therefore necessary that as we consider strengthening our policy, we should retain greater flexibility in applying our strategy to country specific circumstances, with a view to not only prevent or minimize arrears, but also to facilitate those countries already in arrears to quickly resolve this problem. Our current strategy therefore needs modification to close possible loopholes and to address constraints being faced by countries in arrears, including excessively prolonged periods of painful adjustment without financial assistance, and demands for payments by creditors in countries where there is limited short-term capacity to pay.

In our view, our strategy on overdue financial obligations would also substantially benefit from a renewed sense of determination to find innovative and proactive ways for the Fund and other institutions to expedite plans for arrears clearance. This is particularly needed for countries in protracted arrears where, as shown in table 7 on page 40 of the staff report, interest charges have exceeded principal in the cases of Liberia and Sudan. We feel that in the cooperative spirit of this institution, there should be a cutoff point where punitive measures and interest charges cease to be applied for such cases for a limited period of time, thereby opening a window of opportunity for innovative methods to clear such arrears.

Helping countries in arrears is yet another area that needs close Bank-Fund collaboration. This is particularly important in all affected member countries, but especially those that are emerging from conflicts. There is need to properly sequence assistance from both institutions; and there is need to

define the lead institution and to allow it to help pave the way forward without undue restrictions by rules governing other institutions or creditors. There is also the need to remain flexible in applying rules. In our recent discussion on the Democratic Republic of Congo (DRC), it became clear that there were inconsistencies between Fund and IDA policies and that coordination is necessary in the case of post conflict arrears countries. The statement by the Staff Representative seems to imply that the staff has consulted at their level and the issue needs to be resolved by the two Boards.

We believe that the current mechanism for resolving the problem of arrears does not fully address one of the major constraints facing countries in arrears, particularly post conflict cases, that is the need for releasing resources upfront, to help finance reforms and mitigate what could otherwise be very steep and painful adjustment, in the process of bringing about macroeconomic and social stability. In this context, a situation whereby creditors demand payments too early exacerbates the difficulties faced by countries that have no capacity to pay. This is why we support the approach used for the DRC as it comes close to resolving this problem. The key elements of the DRC approach should be seen as a hybrid and further improvement on our current strengthened strategy: (i) the country shows progress toward restoring political and social stability and expresses strong commitment to economic reform, under monitoring by the Fund, and, (ii) the Fund receives some form of token payments, in this case through deposits into an account. The innovation regarding deposits held at the BIS in lieu of direct payment to the Fund is that it addresses three issues simultaneously: first and most important, it allows the Bank to extend IDA credits, since there are no direct payments being made to any creditor, and thereby provides the crucially needed upfront liquidity for the member; it can be viewed as a method of complying with the preferred creditor status of the Fund; and, the deposits remain part of the reserves of the country. At the same time the country is not at liberty in using these resources as such deposits form part of the country's track record of payments to the Fund. In the absence of a standard policy to deal with inconsistencies between IDA and the Fund on this matter, we fully support the approach used in the DRC case and urge its application to similar circumstances on a case-by-case basis, as it allows IDA to give some life support for the country to make tangible progress in the reconstruction and recovery process. To further strengthen this approach, by making it more transparent and enhancing certainty, we support the idea of (iii) having all or some of the deposits at the BIS transferred to the Fund at the time of arrears clearance.

The Rights Accumulation Program (RAP) remains an integral part of a strengthened Arrears Strategy and I support the proposed decision for its extension, given that there remain potential beneficiaries. However, there are elements of the RAP process that need some revisiting. The last bullet of Box 1 of the staff report discusses the duration of RAP which we see as

clearly too long. Countries with large arrears to the Fund, experiencing at the same time large economic imbalances face the disadvantage of having to continue with RAP for the full three-year period of painful adjustment without external financing. It is our considered view, after several years of experience with the current RAP approach, that we have not found the optimal balance in terms of duration. Our preference would be somewhere closer to twelve months as the norm, with flexibility for an even shorter period where circumstances warrant. Our experience on the ground is that prolonged periods of steep adjustment, always and without exception, come at a social and political cost, which in turn often have the opposite effect of delaying economic reforms, particularly for post-conflict countries.

I therefore particularly welcome the flexibility being emphasized for post-conflict countries regarding the levels of payment and the time taken by other institutions, particularly the Bank, to resume lending, taking the particular case of the DRC. However, it is stated in the last sentence of paragraph 13 of the staff report that arrears clearance plans are deemed to be feasible once a post conflict country in arrears has established peace, made adequate progress in rebuilding administrative capacity, restoring macroeconomic stability and re-establish relations with the international community. These are clearly enormous and daunting challenges for a post conflict country and it is not clear that they can be achieved in the very short-term and in the absence of additional resources. We therefore urge that these conditions be applied with flexibility and treated as work in progress. In this context, we re-emphasize the approach applied to the DRC as appropriate. We also urge very strongly indeed that for HIPC eligible arrears cases, performance under RAP, Staff monitored programs and Fund monitored programs should count fully toward reducing the period of track record necessary to qualify for the HIPC and to reach the decision and completion points. In fact we feel that this approach should become the presumption, so that seriously-minded member countries are offered with a greater degree of certainty and a real and tangible additional incentive to pursue sound macroeconomic policies precisely at the moment that the temptation to do otherwise is greater.

In our view, some of the punitive measures applied to deal with cases of arrears to the PRGF are sufficiently tough. However, we believe that the SDR rate charged for arrears to PRGF is too excessive and the Fund should find a way of alleviating this burden, as is the case for arrears to SAF. In addition, the staff suggestion to withdraw technical assistance from countries in protracted arrears to the PRGF runs counter to the cooperative nature of our institution and in these circumstances would be counterproductive, as it could result in forestalling implementation of good policies. Technical assistance to PRGF countries remains critical for strengthening macroeconomic management and spurring resource mobilization, both of which are essential to allow the country to perform on payments and policy implementation. We

therefore do not support the proposed suspension of technical assistance as an addition to the strengthened arrears strategy for countries in arrears to PRGF-supported programs. Our suggestion would be for such technical assistance to be withdrawn only if it is not being used for strengthening capacity for macroeconomic management and resource mobilization, a provision that is already embedded in the Fund's current policy on provision of Technical Assistance.

Our arrears policy for PRGF cases should bear in mind the need for unlocking financial and technical assistance to these countries at an early stage and to expedite the process of debt relief for those countries that are eligible for the HIPC Initiative, if backed by strong policy implementation. In this connection, there is a clear timetable for de-escalation of punitive measures for cases of arrears to GRA resources. Could staff comment on a similar process for the PRGF arrears cases, including, how long it would take for a post conflict and HIPC-eligible country in arrears to the PRGF to be reinstated under the PRGF-eligible list, and, would there be a similar requirement to stabilize arrears in case of a RAP?

We recall our discussion on Zimbabwe, during which we raised concerns about the implications of having issued a press release about Zimbabwe's arrears case, in the absence of a Fund-wide policy on such publicity. We are satisfied that the current paper addresses the issue in the balanced manner which we sought during the discussion on Zimbabwe and in the manner which does not appear to penalize a single member in the absence of clear, predetermined rules. We therefore go along with the phrasing suggested by staff in paragraph 42 of the staff paper.

Mr. Duquesne submitted the following statement:

I would like to thank Staff for this report on an issue crucial to ensuring adequate safeguarding of the Fund and PRGF resources.

Let me first develop my position on the five proposed decisions, before concentrating on the more difficult issue of DRC.

I have no difficulty with Decision No. 1 and Decision No. 5.

Decision No. 2: I can also support the proposed strengthened measures and procedures concerning PRGF arrears. The recent case of Zimbabwe has pointed to the existence of a potential loophole in our PRGF policy, and it seems to me that we should indeed parallel to the greatest extent possible the already existing procedures for GRA arrears.

I have, nevertheless, one caveat regarding the possibility of suspending the provision of technical assistance after arrears have been outstanding for

more than six months. This time frame may be far too short. True, being removed from the list of PRGF-eligible countries after a six-month period of arrears accumulation could warrant such a suspension. But the countries concerned, i.e., PRGF-eligible countries, are amongst our poorest members, for whom technical assistance may precisely represent a crucial instrument to address the difficulties associated with overdue obligations to the Fund. Besides, it seems to me that the other proposed measures, including the ineligibility to PRGF resources and the declaration of non-cooperation with the Fund, already represent sufficient deterrents to the occurrence of arrears. Thus, unless there were insurmountable legal issues involved, I would see merits in instituting more flexibility in the proposed time frame: for instance, the suspension of technical assistance could go alongside with the declaration of non-cooperation, that is, after the obligation has been outstanding for 12 months, rather than 6.

Decision No. 3: I can go along with the proposed strategy concerning the publication of information on overdue financial obligations outstanding for three months. That new policy strikes an adequate balance between the Fund's enhanced transparency policies and the necessity to avoid a premature reporting of arrears of a technical nature.

Decision No. 4: here, let me say that I have the strong feeling that the publication of information on missed repurchase expectations is a topic that does not strictly fall under the arrears policy heading. Missed repurchase expectations cannot certainly be treated as a breach of obligations to the IMF. I understand that it was agreed to come back to this issue during the review of Fund facilities last year, but I would have preferred a separate discussion, to make clear that arrears and missed repurchase expectations raise issues of a different nature and that no negative stigma should be attached to missed repurchase obligations.

That being said, I can go along with the Staff's proposal, which avoids having parallel existing procedures governing the publication of arrears to the Fund.

Turning now to the more difficult issue of the inconsistency between Fund and IDA policies in the case of post-conflict arrears countries:

I must say that, even though there certainly is no silver bullet to solve that difficult matter, I am somewhat disappointed that no clear policy solution emerges from the discussions between IMF and IDA staff.

During the July discussion on the Democratic Republic of Congo (DRC), the Board had agreed that the IMF staff should consult with IDA staff, with a view to improving the consistency between the policies of the two institutions.

The ad hoc recommendation concerning the DRC formulated in this paper is not, in my view, an adequate basis for forming a clear strategy designed to solve the inconsistency between the Fund's policy on arrears and IDA's policy on grants to post-conflict arrears cases.

True, payments, even minimal or symbolic, are and must remain an integral part of the Fund's arrears clearance strategy, as a benchmark to assert the willingness to cooperate with the Fund. True, also, net transfers must be measured over a reasonable time horizon.

It is difficult to accept, on the other hand, that IDA grants, which are as scarce a resource as those provided by the Fund—and are indeed even more concessional—could be used for clearance of arrears toward multilateral organizations. IDA grants are dedicated to poverty alleviation projects and cannot be used for arrears clearance; such a utilization has been in fact overlooked by the IDA deputies last June in Addis Ababa. Proceeding otherwise would result in a “domino effect,” whereby diverting highly concessional resources from reconstruction and poverty alleviation projects would ultimately impact negatively the fight against poverty.

Against this background, I find it impossible to accept Staff's proposal, whereby a Board decision should be taken no sooner than the next review of the DRC's arrears to the Fund and no later than the completion of the staff-monitored program. In a spirit of compromise, my proposal would be the following: indeed, the IMF Board could decide to request a transfer of the amounts accumulated in the BIS account, but only after the elaboration of a strategy for arrears clearance of the DRC.

The Deputy Treasurer (Mr. Newman) made the following statement:

This year's annual review of the Fund's arrears strategy is somewhat different than some of our most recent reviews, in part because several substantive issues have emerged during the course of the year.

As Directors may recall, during our discussion of Zimbabwe's emerging arrears to the Fund, concern was expressed that there is a lack of a general policy and procedures for dealing with PRGF-only arrears. The current paper seeks to address that gap by suggesting procedures that parallel as much as possible the current policy with regard to arrears to the GRA.

In addition, during the course of the year, and particularly in connection with the staff-monitored program for the Democratic Republic of Congo, an issue arose regarding the consistency of the Fund's policies on payments by countries in arrears and the new World Bank policy on IDA grants for protracted large arrears cases. The staff has been engaged with the Bank over the last few months to resolve the differences, and the status of

those discussions are reflected both in the staff paper and in the subsequent staff statement.

Finally, during the review of facilities and, in particular, during the discussion on the adoption of a policy on early repurchase expectations, the Executive Board requested that the policy of publication regarding missed repurchase expectations be considered in the context of the review of the arrears strategy, even though it was recognized that missed repurchase expectations and arrears are very different issues, and there was a strong desire to avoid any perception that missed repurchase expectations were in some way similar to arrears. We have tried to make that distinction in the staff paper and in the proposals for publication with regard to missed repurchase expectations, but we would agree with Mr. Duquesne that taking up this issue in the context of an arrears paper was probably a mistake, and that it would have been better to handle them as separate issues.

Mr. Collins made the following statement:

I am grateful to the staff for this paper, which addresses some of the issues that have arisen in recent discussions. On most of the issues I can be supportive, but I do have some concerns on both process and substance. I can agree, with two provisos, with the proposals to extend the rights approach, to establish a timetable of procedures to address arrears to the PRGF Trust, and the proposals for publication.

The first proviso is in relation to the proposal to suspend technical assistance to PRGF-arrears cases after six months. I agree with those Directors, such as Mr. Duquesne, Mr. Rustomjee, and I think there are others, Mr. Shaalan maybe, who think that this is probably not the right approach, and that clearly it will have to be judged on a case-by-case basis. If a country is clearly benefiting from technical assistance (TA) and is making efforts, albeit insufficient, TA ought to be allowed to continue on a case-by-case basis. We should not rule out the possibility because we might just be cutting off our nose to spite our face.

The second proviso relates to this question of repurchase expectations. I do not disagree with what is proposed in the staff paper. I would just like to remind the Board that repurchase expectations under the SRF have a slightly different status than those for the SBA and the EFF. I think that programs drawn for SRF cases are on the basis that repurchase expectations will be met, whereas for the SBA and the EFF they are drawn up on the basis that the obligation will be met. Therefore, there is a stronger expectation in relation to the SRF, and I believe the same will be the case for the CCL whenever one is activated. I am not sure whether there is a difference legally, but if one wanted to make a distinction at the time of publication, one could use that as a criterion, but I am not advocating that, I just note it for the record.

I will now move on to the most substantive areas where I think the paper has either failed to address issues or not addressed them satisfactorily in my opinion. One issue that it fails to address at all arose in the case of Zambia, and the fact that its rights accumulation program led subsequently to a big increase in repayment obligations to the Fund, coincidentally with the introduction of, I think, its HIPC decision point. Now, of course, at the time that could not have been foreseen as I expect that its RAP must have preceded the HIPC program. In any event, we learned a lesson then, and we thought this question would be addressed in this paper. As I recall, it is not addressed at all. So, I would be grateful at some point if the staff could look into that.

Second, I would strongly support the point made by Messrs. Wijnholds and Azoulay in their statement relating to the need to modify the existing strategy for dealing with current arrears cases. In other words, the prevention strategy seems to be working to a degree, but for current arrears cases we are only making a small amount of progress, especially with regard to the major one in Sudan. One does not sense that there is a radical proposal here on the table. Now I know that one is very difficult to conceive, but I think as the staff has attempted to take a broader view this year, it would have been good if it could have thought, to use that awful phrase, a little bit outside the box, and I know the Deputy Treasurer in his previous existence would have had much more radical thoughts on these kind of things. Perhaps he can try to relive his former life a little bit.

The major issue I want to address is the question that arose in the case of the Democratic Republic of Congo and the question of the IDA grant. In a sense this might seem like a kind of minor point, and the fact that it has not arisen until now would tend to substantiate that except that many of the countries in arrears will increasingly be post-conflict cases that might be able to benefit from this IDA facility. My first concern is on process, where we remain concerned by the apparent inability to find a solution that is acceptable to both the Fund and the Bank staffs on what does seem to be a fairly technical matter. The Deputy Treasurer referred to the IDA policy as a new one. We have done a little research and have found that it in fact goes back, at least in writing, to papers back in September 1998, joint Fund/Bank papers where this was referred to, and there have been a number of papers since that time. So, this might be the first time it is been applied, but it is certainly not a new policy. It is a pity that the staff appears to have been taken by surprise when it did arise. It is also a pity that a more general solution that is acceptable to both the Fund and the Bank staffs has not been developed yet, as is clear from the supplement paper. I would be interested to know whether management of the two institutions have discussed this, or has it just been done at the level of the staff, because it does not seem too difficult to conceive of a solution that ought to be mutually acceptable, and that is what I am coming on to now, which is the substance.

We agree, of course, with the elements that underpin the Fund's overall approach to arrears, but we do believe that in the small number of cases where there is the possibility of an IDA grant some modification is needed to make sure the Fund's and the Bank's policies are mutually reinforcing. Now, the mechanism I am going to suggest is not at all novel, it just builds on what already exists, but we ought to generalize it more than the way the staff appears to have been approaching it so far. The mechanism would involve allowing a track record to be established for preferred creditors to be treated on a *pari passu* basis, and it would ensure that IDA grants are not used to repay arrears to the Fund or to anybody else. The framework would be to accept deposits with the BIS or some other mutual arrangement instead of immediate payments to the Fund in these limited cases, which would allow the country to build a track record of commitment and of course if payments are not made or they fall short into that account, that would be considered by the Board as a failing in the track record, which should be made absolutely clear to the country concerned, so that even if it is not an escrow account and the funds are part of the country's reserves, morally it would be looked upon as a sort of escrow account if not legally.

Second, it should be agreed in principle that the deposits be transferred to the creditors at the time of arrears' clearance, and finally, while the presumption is that this framework would be applied, it is clear that the agreement on the applicability of such an approach in any given case will need to be determined by the Board at that time. Now, that clearly has an element of case-by-case, but the presumption would be that it would be applied, and then the case would have to be made, presumably by the staff, as to why it should not be applied in any particular case. So, I think that it would be quite easy to derive that kind of more general approach out of what the staff has accepted in the case of the DRC, and it would be interesting to hear the views of the Bank staff on this whole question.

My final point is really to pose the question either to the staff or to Mr. Rustomjee as to their views on Zimbabwe. I know we have a review scheduled, but it would be interesting to hear what they have to say. We were led to believe that within six to eight weeks of the last Board discussion, when the tobacco crop expected to be in, Zimbabwe would make some payments and would clear its arrears, and I would be interested to know what news we have on that.

The Acting Chairman (Mr. Aninat) noted that Fund management had been in touch with its Bank counterparts on the issue of how to reconcile the IDA policy with the Fund's policy on arrears.

Mr. Rustomjee replied that Zimbabwe had been expected to make some payments once its tobacco crop proceeds were realized. However, there had been no indication from the authorities that any payment would be forthcoming in the near term. In addition, the

situation in Zimbabwe had deteriorated since the time of the last Board discussion on Zimbabwe. Nevertheless, he would remain in close contact with the authorities regarding the situation.

While progress had been made in reducing the arrears of those countries that had fallen behind in their payments to the Fund for a period of less than three years, there had been no progress made by those countries with protracted arrears since 1990, Mr. Rustomjee noted. Furthermore, most of the arrears were concentrated in two or three of the protracted cases. Therefore, it was important to find a solution to this problem, particularly as in at least two cases the interest on overdue obligations was exceeding the original principal amount, which made it difficult for policymakers in those countries to try and address their arrears situation.

Mr. Quarles made the following statement:

We believe that maintaining a robust approach to dealing with overdue obligations is central to preserving the principles and operations of the Fund, and therefore we broadly support the staff proposals. I will comment briefly on the proposed decisions and on a few of the issues that are raised by the paper.

First, with regard to the rights approach, we view the RAP as a successful program that has helped improve the Fund's financial position. With the help of the RAP, several countries have repaid their arrears and normalized their relations with the Fund. We agree with the proposal to extend the availability of the RAP for another year.

As has already been mentioned in a couple of the statements and in the discussion today, the Zimbabwe case highlights the need for a stronger policy for dealing with PRGF arrears. The staff has proposed a number of steps to make the arrears policy for the PRGF as parallel as possible to that for the GRA, and we support that approach. But, there are nonetheless still differences, and we remain concerned about the potential for those in arrears to the PRGF to be treated more leniently than those in arrears to the Fund's general resources.

The staff paper stresses the need for flexibility in the approach to post-conflict countries, several of which are in significant arrears, and emphasizes the merits of a case-by-case approach. We believe that flexibility in the amount of payments may be appropriate, but that it is critical that the principle of demonstrating a willingness to pay and the discipline to do so be maintained. Moreover, it is crucial that we insist not only for commitments to policy reform, but also for a track record of performance accumulated over a sustained period of time.

Somewhat related to this last point, there are a number of cases where, in light of ongoing domestic problems in some arrears countries, the Fund has

not reviewed those cases or pursued remedial measures for several years. This is a difficult situation. We would argue that action cannot be postponed indefinitely, and perhaps the staff could comment on that.

With regard to transparency and publication, the staff has proposed to strengthen the publication policy for cases of arrears as well as for missed repurchase expectations. We agree that to foster greater transparency and enhanced timeliness, publication of new arrears cases should be made more expeditiously, and press releases regarding all subsequent decisions on arrears cases should be standard practice. We would like to go further and suggest as well that a quarterly breakdown of arrears by country should be published. This is not information that is publicly unavailable currently, but it can be brought together in a way that is easily assimilated, and precisely because it is already publicly available, there should be no objection to the enhancement of transparency by making this quarterly publication of arrears broken down by country.

Let me now move on to the conflict, at least in the case of the DRC, between the Fund arrears policy and the IDA grant concerns, which preceded my recent arrival to the Board. When the Fund faced that conflict in July 2001, in our view a tenuous and nebulous compromise was worked out. At that time, the staff was asked by the Board to design a more consistent and coherent policy. I was not present for that earlier discussion, but I do not see that this paper shows any progress in working out a consistent understanding on this issue.

As we stated in July, we continue to believe that it is not inconsistent with the principles or the terms of the IDA grant instrument for the Fund to be repaid in some manner in a de minimis amount, even while the IDA grant is being disbursed, and for those funds to be directly applied toward regularizing arrears clearance. As we stated then, and as I think is evident from the terms of the instrument, the requirement both in principle and by its terms is that arrears continue to accumulate, not that no effort be made toward making any regular payments. For the Democratic Republic of Congo, if what is now being deposited at the BIS were directly applied toward regularizing arrears with the IMF, arrears would continue to accumulate. Therefore, both in light of that and in light of the possible precedent that this could create, particularly given the large arrears cases that could come forward in the future, we feel very strongly that the compromise agreed for the sake of the Democratic Republic of Congo poses a serious risk to Fund policy. We agree with the staff that the Fund should retain the discretion to determine the amount of payments that a country should make directly to the Fund. In this regard, the case of DRC is exceptional.

We support the staff proposal to transfer the resources from the BIS account to the IMF at the next review or at the completion of the SMP. More

broadly, we strongly support the staff's call for the Fund to continue its policy of requiring countries to demonstrate a track record of payments directly to the Fund as part of an effort to normalize relations with the IMF.

Mr. von Kleist made the following statement:

The assessment of overdue financial obligations to the Fund shows a rather mixed picture: The reduction in the overall amount of overdue payments to the Fund is welcome. It is disappointing on the other hand that a new case of arrears to the General Resources Account and a major case of arrears to the PRGF Trust Fund have occurred. Another matter of concern is the high share of arrears concentrated in one member country.

We support the set of proposed decisions. I only want to briefly comment on recent developments and highlight some specific policy issues:

The level of arrears to the Fund has only been reduced slowly recently. Besides the one-off effects of the clearance of the arrears of the Federal Republic of Yugoslavia, there have been no major improvements. In a medium-term view, the process has stagnated since 1995, after considerable progress in the years before.

We are encouraged by the continued cooperation and payments of the Sudanese authorities after so many years of non-cooperation. The payments themselves, however, are rather small and could and should certainly be increased.

We are extremely concerned about the first occurrence of arrears to the PRGF Trust Fund. Arrears severely threaten the viability of the process as a whole. Furthermore, the cases of short-term arrears—those of six months or less—to the Trust Fund deserve special attention. All arrears cases, whether in the General Account or in the Trust Fund, need to be pursued with high priority.

Mr. Chairman, we are surprised by the long list of member countries with overdue currency valuation adjustment obligations. The amount—more than 2.6 billion SDRs—seems to be on the high side, even when these overdue payments are not included in the arrears strategy.

Now let me turn to policy issues:

The recent case of arrears to the PRGF Trust Fund stresses the need to improve and to extend the Fund's arrears strategy also to PRGF cases. The proposed approach seems reasonable—taking into account the legal framework and the specific nature of the Trust Fund.

With regard to the transparency issue, we can go along with Staff's proposals for an increased publication strategy. Our recent policy for more openness in the Fund should not exclude arrears. Probably, the threat of public announcements of overdue financial obligations to the Fund will also create strong incentives to respect the preferred creditor status of the Fund and encourage payments on time.

We support Staff's proposals to establish measures to deal with arrears in the PRGF Account. We suggest going one step further: After two months of arrears, in addition to a report to the Board, the other multilateral creditors should also be informed simultaneously.

Finally, we are still concerned about the procedure of handling repayments of the Democratic Republic of Congo to the Fund. As already indicated at the recent review of DRC's overdue obligations to the Fund on July 13, we are puzzled by the incomparability of regulations between different international institutions: We still feel that the monthly deposit of SDR 100,000 at the BIS is not really the same as actually repaying overdue Fund's resources. The amount is also astonishingly small, only 0.2 percent of DRC's exports. The deposits are still part of the DRC's reserves, even though the transactions and holdings of the BIS account are monitored by the Fund. Is our understanding correct that the Fund has no legally binding leverage to intervene in a potential use of these deposits by the authorities for other purposes than repaying the Fund? I would welcome a staff response to my question. We do not need to go into the full details of the DRC case today, and we can go along with the proposal to come back to this issue at the next review of DRC's arrears in mid-January next year. However, I want to make sure that by allowing the DRC case to continue, we do not set precedents for other cases and I can certainly not agree to a general solution as outlined by Mr. Collins.

I strongly support staff's view that the Fund retain the flexibility provided under the arrears strategy to determine the amount of payments to the Fund as a test of cooperation rather than adopt a policy of no payments for countries receiving IDA grants.

Mr. Kiekens made the following statement:

Unfortunately there has been little progress since 1995 in reducing the magnitude of overdue obligations to the Fund. Both the number of countries with protracted arrears—seven—and the total amount of their arrears—around SDR 2.2 billion—remain unchanged. This represents a substantial burden for the rest of the membership. I urge these countries to make a start at repaying their overdue financial obligations to the Fund. Countries with overdue currency valuation adjustments should also settle their arrears without delay.

There have been some signs of light in this darkness. Yugoslavia's clearance of its arrears with the Fund last December was the most positive development of the past six years. Sudan's improvement in policy and payment performance during the past two years is welcome and should be strengthened. Moreover, if the Democratic Republic of Congo's cooperation with the Fund continues to improve, the way may be open for Congo to clear up its arrears to the Fund.

But, the absence of progress by the other arrears-ridden countries, or worse, the deterioration of their situations, is disheartening.

The recent addition of Zimbabwe to this group of countries—the first new case of arrears since 1995—is the most discouraging development. Zimbabwe's accumulation of arrears to the PRGF will undermine efforts to raise additional loan resources for the PRGF Trust. Zimbabwe's default has torpedoed our most powerful argument for persuading countries to lend to the PRGF Trust, namely that no country had ever incurred protracted arrears to the trust. The case of Zimbabwe highlights the need for more detailed procedures for correcting PRGF arrears. I support the proposed decisions to that end. I also support the other proposed decisions concerning the extension of the rights approach and the publication of information on arrears and failures to meet repurchase expectations.

Mr. Rustomjee, in his excellent written statement, argues in favor of shortening the duration of rights accumulation programs. For him, this would restore equal treatment between arrears countries that must implement a rights accumulation program as a condition for new Fund financing, and arrears countries that can obtain new Fund financing without a rights accumulation program after having received a bridge loan from supportive countries. We should carefully consider Mr. Rustomjee's proposal. However, we should not lose sight of the fact that countries with a rights accumulation program need to build a strong track record of good policies in order to obtain access to Fund financing that is exceptionally high in terms of their quotas. In several instances, the amounts of the arrears to be cleared exceed normal access limits. For good reason, the track record should be longer when the amount of rights to be accumulated is larger in relation to the country's quota.

As to the Democratic Republic of Congo, like other speakers I am disappointed by the lack of progress, since the Board meeting of July 13, by the staffs of Fund and World Bank to find an acceptable solution. We need to reconcile the Bank's policy on providing IDA grants with the need for the DRC to build a satisfactory track record of payments to the Fund as a step toward clearing its arrears.

I agree with Mr. Collins that by putting money aside in a trust account specifically designated for repaying overdue obligations to the Fund, the

World Bank and other preferred creditors would allow the Fund to monitor the country's progress in settling its arrears, in accordance with the spirit of the Fund's strategy on arrears clearance. The country's monthly payments into the trust account could easily be made a performance criterion of the Staff Monitored Program that an arrears country must implement before it can resume normal relations with the Fund. The IMF's share of the money thus paid into the trust account will be paid to the Fund at a later stage, together with the money from the bridge loan that will still be needed to fully clear the country's arrears with the Fund.

But like Mr. Quarles, I fail to understand why a direct monthly payment by the DRC of SDR 100,000, which is about one-tenth of the additional arrears to the Fund that the DRC is still accumulating each year, would violate the World Bank's policy on IDA grants. Given that the DRC's total annual obligations to the Fund amount to SDR 12 million, it would seem that the direct payment to the Fund of one-tenth, which is SDR 1.2 million, should be perfectly compatible with the conditions attached to IDA grants which require that "other creditors have agreed, at least, not to make net withdrawals of financial resources from the country" (see paragraph 28 of EBS/01/122). Some clarification by World Bank staff would be welcome. The best way for the World Bank to ensure that IDA grant resources are used for reconstruction needs would be to allocate them to specific projects. This is already being done in the DRC. Imposing an additional requirement that countries receiving IDA grants cannot use any other resources to start repaying their creditors is clearly excessive.

The time has come for the Bretton Woods institutions to harmonize their policies on the reduction of arrears. I would like to propose the following as principles for such a common policy:

First, when a country in arrears begins repaying its preferred creditors, it should treat them *pari passu*, that is to say that its payments to its various preferred creditors should be commensurate with the relative importance of those creditors' claims.

Second, IDA grants should indeed be devoted to reconstruction needs, but this should be considered as compatible with *pari passu* progress toward the clearance of arrears owed to preferred creditors.

On the basis of these principles, I could accept either the first solution under which the DRC sets money aside at the BIS to clear its arrears to the IMF, the World Bank, and the African Development Bank, or the second solution under which the DRC makes direct repayments to its preferred creditors. I clearly prefer the latter solution.

Mr. Rouai made the following statement:

We welcome the review of Fund's strategy on dealing with arrears, and appreciate staff's recommendations for strengthening it. Like Mr. Rustomjee, we believe that members' implementation of prudent policies, combined with Fund surveillance and provision of adequate technical assistance, forms the appropriate policies that help to prevent the emergence of arrears. In the current review, while we regret that Zimbabwe represents the first country with protracted arrears to the PRGF Trust, we consider the strategy an effective deterrent tool in safeguarding Fund resources and an appropriate vehicle for assisting arrear cases to restore their financial standing with the Fund. We welcome in particular Yugoslavia's clearance of arrears and Sudan's continued payments. Due to these encouraging developments and the policy's efficiency in resolving several arrear cases, we support the extension of the RAP by one additional year.

On the timetable of addressing financial obligations to the PRGF Trust, we support most of the proposed measures to parallel those applied to the GRA arrears. However, like Mr. Kelkar and Mr. Shaalan, we doubt the usefulness of removing a member with six-month outstanding arrears from the list of PRGF-eligible countries. In addition, suspending technical assistance at an early stage could limit the opportunities for dialogue and cooperation between the Fund and the country. It would be preferable to consider suspending technical assistance on a case-by-case basis and only after twelve- and not six-month period of outstanding arrears, as proposed by staff.

On coordination with the World Bank in dealing with particular cases, while it is important to stress the preferred creditor status and the importance of regular payments to the Fund as a signal of the country's good will, it is equally important to apply Fund's rules with flexibility and be more cognizant of countries' financial constraints. These considerations are particularly relevant to post-conflict countries, as evidenced in the DRC case. Pending better understanding among the IFIs, we support the course of actions proposed by staff.

On publication of arrears, while we support the proposal to publish information on arrears that are outstanding for three months, we have reservations about treating missed repurchase expectations under the review of Fund's arrears since they do not constitute a breach of obligations to the Fund. We are willing to discuss this issue and even support the staff's proposal if made later at an appropriate venue. For the time being, we cannot support the proposed decision.

Finally, we agree with staff that overdue currency valuation adjustment does not affect the Fund's financing capacity and that it occurs due to delays in legal and administrative procedures. However, as some of the

amounts reported in Table 8 involve countries in protracted arrears that have been outstanding for several years, staff should be more proactive in this area. These delays should be reported on regular basis in the Article IV consultation reports, and their regularization by countries in arrears should be part of the test of cooperation with the Fund.

Mr. Kudiwu made the following statement

We welcome today's Board discussion on the review of the overdue financial obligations to the Fund. We are pleased to note that since the last review in June 2000, overdue financial obligations to the Fund has declined, but we note that the decline was not so large. Nevertheless, we welcome the clearance of the arrears made by the Federal Republic of Yugoslavia and the payments made by Sudan. In this regard, we note that about half of the arrears to the GRA are accounted for by Sudan, and that the country has made good progress in the recent past to strengthen cooperation with the Fund and is making regular payments. This is very encouraging and is an indication that our cooperation strategy remains appropriate to deal with the issue of overdue financial obligations. While welcoming these developments, we regret, however, that for the first time one country, namely Zimbabwe, has accumulated payments arrears to the PRGF Trust. We hope an early solution can be found in this case, so as to avoid the deterioration of the situation.

Regarding our arrears strategy, we agree with the staff that the first line of defense is the prevention of arrears, and in this context we need to strengthen our cooperation with potentially weak countries at an early stage. The Fund should, where necessary, increase the technical assistance provided and at the same time continue to assist in its efforts to receive adequate financial assistance. Experience has shown that interruption of Fund and donor's support have often worsened the situation, and the Fund should make every effort to remain involved in those countries which are going through major difficulties.

On our arrears strategy, we note that the flexible approach followed, and which takes into consideration each country's special case and payments capacity, has been instrumental for the implementation of the strategy.

We also agree that there is a scope for closer collaboration between the Fund and the World Bank, especially in helping post-conflict countries. Flexibility and an understanding of the financial constraint faced by the country are important factors to consider as illustrated by the differing approaches followed in the cases of Sudan and the DRC. In the latter, close collaboration between the Fund and the World Bank has been deemed important. The two institutions have worked closely to prepare an arrears clearance plan with the member country.

However, as the case of the DRC shows, this approach can lead to problems, as payments to the Fund conflict with Bank policy on providing IDA grants. We commend management and the staff for the pragmatic solution that has been put in place, and which has enabled IDA grants to be released and the staff-monitored program to be put in place. The positive steps taken by the World Bank as regards payments issue, and which take into account the emergency needs of a country, the recovery project, the humanitarian tragedy and the reconstruction needs, are welcome. Technical assistance should be reinforced to address budget management and expenditure control, as well as strengthen efforts for the mobilization of domestic resources.

An intensified collaboration is also critical to enable countries to establish ambitious, but realistic track record of policy implementation and payments to the Fund. Emphasis should continue to be put on the need to mobilize bilateral and multilateral financial support, to find the end of the tunnel in a reasonable time frame, and for a gradual clearance of arrears to other creditors, without neglecting the Fund's preferred creditor status.

With regard to the rights approach, we are of the view that it is part of the strengthened arrears strategy and we support its extension for another year until end-August 2002. However, in post conflict cases a more flexible approach could help the country restore macroeconomic stability more quickly. We would also reiterate the view that for post-conflict countries which are HIPC eligible, the performance under SMP and RAPs should count toward the track record needed under the HIPC Initiative.

Overall, we can go along with the proposed decisions, except for that relating to technical assistance. We are of the view that the Fund should show flexibility in this area. Countries that fall into arrears are those that, among others, have weak administrative capacity, and by denying this assistance to a member, we may be making it more difficult for that country to start the process of normalization of its relations with the Fund. We would, therefore, suggest that we keep an open mind on the issue of technical assistance. Moreover our approach should also include incentive measures that will encourage countries to make faster progress towards a normal situation.

On publication of information on overdue financial obligations, we can go along with the proposed decision, to provide greater transparency, without hampering efforts to resolve arrears of a temporary or technical nature.

Finally, on publication of information on missed repurchase expectations, we have no difficulty to support the proposed decision.

Mr. Yanase made the following statement:

While I welcome the recent reduction in arrears to the Fund, it is disappointing that the broad level of total arrears has remained almost unchanged over the past several years. Moreover, I am concerned by the fact that most of the countries that have accumulated a significant amount of arrears have failed to make substantial progress in reducing them. It is also disturbing, as stated by many of the other Directors, that the first significant case of arrears to the PRGF Trust happened during the period under review. In order to maintain and protect the revolving nature of the Fund's resources in both the GRA and the PRGF Trust, it is essential to ensure that arrears not only do not increase, but also are reduced substantially in the future. In this context, I appreciate the staff's proposal and support the proposed decisions. In our view, these measures are necessary and indicate improvements in the current framework of our strategy on arrears.

With regard to the measures on PRGF arrears, I hope that the strengthened procedures will prevent the further occurrence of arrears to the PRGF Trust. However, as Mr. Rustomjee and others emphasize, arrears often arise because of issues beyond the authorities' control, such as conflict. Strengthening sanctions alone will not help reduce arrears in such cases. We stress the need to be flexible in helping these countries, for example, by being flexible in applying the restriction on the provision of technical assistance.

I would like to touch on two other points in the paper for emphasis. First, we support the proposal on the treatment of missed repurchase expectations. However, I share the concern raised by other Directors that missed repurchase expectations should not be confused with arrears and appreciate the Deputy Treasurer's explanations that the staff agrees with this. I would like to stress therefore that care should be taken in formulating the language of the text that will be published on the Fund's web site. That language must make clear to all readers that a missed repurchase expectation is different from incurring arrears as the former does not constitute a breach of obligations under the Fund's Articles of Agreement.

Finally, turning to the issue of treatment of payments to the Fund in arrears cases when IDA grants are involved. I would like to confirm my support of the staff's position that recurring payments is an essential part of demonstrating cooperation with the Fund. It is also important that this principle be applied to all members. That said, some flexibility is warranted, and I believe in the case of the Democratic Republic of Congo making payments to the account established by the authorities with another institution is a good compromise. In fact, as Mr. Wijnholds and Mr. Azoulay state, if the accounts can be monitored by the Fund, making such payments can perform the same function as direct repayment to the Fund as the country cannot take money from the account without endangering its cooperative arrangement

with the Fund. Thus, provided the amount deposited in the account is transferred to the Fund when arrears to the Fund are cleared or when repayment is deemed necessary by the Fund, I can support use of such an account in very limited cases, and as an exception to the general rule. Nevertheless, I sympathize with the inquiry of Messrs. Quarles and Kiekens as to why such a small amount of direct payment to the Fund undermines the conditions of the IDA grant. Indeed, we may expect the World Bank to show a little flexibility if the Fund is going to show a little flexibility in applying our arrears strategy. So, I hope further discussion will take place between the two institutions by the time of the next review.

Mr. Callaghan made the following statement:

Overall we support the proposed draft decisions, although there are a few qualifications, if not a little bit of unease in our support. However, I agree with the points that Mr. Shaalan and Mr. Bakhache, Mr. Wijnholds, Mr. Collins, and Mr. Rustomjee made about this issue. If we look at the tables, particularly Table 4, the problem of arrears, is not really a widespread or a growing problem as we mostly have larger overdue obligations becoming protracted in a smaller number of countries. That is a very important issue we really have to sort of try and tackle head on. If we want to make real progress in trying to reduce arrears, we do have to have a very targeted approach toward a couple of specific countries. I know that is very easy to say, and Mr. Rustomjee in his statement said we need innovative solutions and Mr. Collins talked about a radical approach. Well, I am not sure what they refer to, but that is the heart of the issue. If we really want to make progress in this matter, we do have to focus on a couple of countries and come up with some solutions.

In terms of this issue of the inconsistency between the payments to the Fund in arrears cases and IDA eligibility, we, like others, had hoped that we were going to get a more definitive resolution of this inconsistency. The current arrangement we have in place for the DRC is really a device that we hoped was just going to be used to get around what was really a short-term problem. We are uncomfortable with this approach as we seem to be trying to use a loophole to get around the rules of our institutions, and simple solutions are usually the best solutions.

When a member gets in arrears to the Fund, they have real problems and significant difficulties, and the only way they are going to overcome these difficulties is by reengaging with the international community and getting the support of the international community, and the only way they are going to do that is by normalizing their relations with the Fund, and the important path toward normalizing those relations with the Fund is by establishing a payments record. It is a very important part of the arrears strategy to get those payments going to indicate to the international community that the country is

on the way out. I think that is why the Fund does have to be a preferred creditor and has to be treated as such. While we can see the rationale for the IDA policy, I think that the position of the Fund and the need for countries to normalize their international relations is an important issue that has to be recognized.

However, we do not want to penalize the DRC for trying to come to a solution. The case of the DRC was a pragmatic compromise to allow the country to demonstrate that it had this payments track record, but it was only a proxy. It seems as though Mr. Collins's solution, if I understand it correctly, attempts to take away the ad hoc or proxy element and tries to establish it as a formal policy. We, however, would prefer to go back to the basic issue, the first principles, and try and solve that. I prefer the proposition that Mr. Kiekens and Mr. von Kleist were proposing, if I understood them correctly, that the way to solve it perhaps is if we get IDA grants directed toward specific reconstruction needs, we can then overcome what seems to be at the heart of the issue of the IDA policy. We certainly agree that in looking at this the Fund has to retain discretion to determine the amount of payments on a case-by-case basis, because I think throughout all this we put a very big emphasis on the need for flexibility. As I say, these countries are in very difficult circumstances, and flexibility will be required throughout the whole approach.

On the procedures to address the financial obligations to the PRGF Trust, we agree that it is appropriate to try and have a more formalized procedure to establish a clear timetable of steps to address PRGF arrears, parallel to those under the GRA. But, I think it is always important that we do not get caught up in a rigid procedure for handling arrears. We need to have flexibility and discretion. Like others, we are very concerned about suspending technical assistance because in many respects, providing technical assistance is part of the solution in trying to overcome the arrears problem. I think it is important that discretion be used in suspending technical assistance, and it is a discretion that should only be used in very extreme circumstances. However, if we start identifying steps at the start, we will not be able to say that there is not a rigid procedure.

On the question of publication of information, we support the proposal that information on arrears be published at the three-month point. On publication of information on missed repurchase expectations, I have a lot of sympathy with the points that Mr. Kelkar raised and others have raised, which is that we do not want missed repurchase expectations to be treated as a breach of obligations to the Fund. I am not quite sure how we can solve this problem, but I think that in keeping with the broader approach to transparency, it is appropriate that information on missed repurchase expectations should be published, but again we still have that unease as to

whether we are adequately distinguishing a breach of repurchase expectations and obligations.

Certainly we support the extension of the rights approach.

Finally, on this question of overdue currency valuation adjustments, in the case of Australia the problem was that we had a reconciliation problem, and the good news is that we have overcome the reconciliation problem, and we are just in the process of making those payments.

Mr. von Kleist noted that he supported Mr. Kiekens's idea to earmark IDA resources to specific reconstruction needs.

The Deputy Treasurer (Mr. Newman) made the following statement:

I would like to focus on a number of issues that were raised in the discussion and in the context of the written statements, and they fall into several broad categories. There were several issues regarding the proposed PRGF procedures. There were a number of issues regarding the RAP, both the length and how you should accumulate charges in the context of a RAP. There was a question about Zambia and whether or not we were going to address the bunching issue, and then there were a series of comments and questions regarding the broader issue of coordination between the Bank and the Fund on arrears clearance and the specific case of the Democratic Republic of the Congo.

With regard to the proposed PRGF procedures, what the staff has tried to do is to parallel as much as possible the procedures that now exist with regard to arrears to the GRA. The GRA-related procedures are flexible and the timetable that is applied can be shortened or extended to the Board's wishes. Several of those procedures are directly related to provisions in the Articles of Agreement, particularly with regard to complaints, declarations of ineligibility, suspension of voting rights, and the compulsory withdrawal of a member. Those provisions do not apply in the case of the PRGF Trust Fund, as obligations to the PRGF Trust are not direct obligations of members under the Articles. Therefore, the approach that we had to take with the PRGF Trust Fund needs to be somewhat attenuated from the procedures that would apply to the GRA.

In that context, a number of Directors have expressed concerns about the proposal to have a declaration of ineligibility for the PRGF that is similar to but does not have the same full force in the Articles as the declaration of ineligibility with regard to the use of the GRA. The GRA declaration is, of course, a precursor to subsequent decisions on suspension and compulsory withdrawal, and would normally occur at roughly the six-month mark.

Under the current GRA procedures, at the time of the declaration of ineligibility, the Board also considers the issue of technical assistance, and the staff has proposed that the same kind of consideration occur at the same point under the PRGF. The Board has full discretion to determine whether to continue or to suspend technical assistance at that point under the GRA; there is no automaticity in that case. The same flexibility would also occur in the case of the PRGF procedures that we are proposing. A second step occurs when you have a declaration of noncooperation, both under arrears to the GRA and what is being proposed in the context of arrears to the PRGF Trust Fund. The issue changes slightly in procedural terms with respect to the PRGF Trust Fund, but not in detail. At that time the Board can decide to continue to provide technical assistance or not by a simple majority vote, but discretion exists.

Several questions were asked about the RAP. We would certainly agree with Mr. Kelkar's statement that it is highly likely that the RAP extension would have to occur again next August to deal with the remaining three cases that might or might not be resolved before then. He suggested or asked why we do not have a permanent RAP mechanism. When the Board adopted the RAP, it was intended not only to be targeted at what were then already large arrears cases, but also to avoid the impression that the Board was either anticipating or condoning future large arrears cases. The Board has considerable discretion in determining the length of a RAP in light of a country's track record on policies and payments, the level of arrears, and also the availability of resources with which to address the arrears problem. In some cases we have been able to have very short RAPs. In other cases they have taken a longer period of time. I would also point out that while the RAP is limited to the original eleven cases and now just the remaining three, the Fund does have other mechanisms by which it can achieve the same end, which gives another reason why you may not need a permanent RAP-like device.

Mr. Collins asked the question about why we have not proposed a solution to the Zambia bunching problem. I think our response to that would be that there is no general solution to the bunching problem. You need to look at the situation of each individual case, and, in particular, the availability of financial resources to address the bunching. The staff has committed that, in the context of future HIPC Initiative cases, it will seek to provide approaches that will avoid the bunching problem, based on methods that are consistent with the specific situation of the country involved; there is no one-size-fits-all solution to the bunching problem.

Let me turn now to the question of the coordination of Fund and Bank policies on arrears clearance. First, let me assure the Board that the staff has made extensive and intensive efforts to seek a resolution of this issue. As the Acting Chairman noted, management has been involved as well. You will

notice that in the staff paper we have incorporated verbatim the World Bank's views, and that has also been done in the context of the supplementary staff statement for today's discussion. At the end of the day, however, the staff did not believe it could or should undertake an arrangement that would undermine the Board's discretion in determining the level and profile of payments that would be considered as part of the test of cooperation. Payments have been an integral part of the test of cooperation from the outset, and the Board has wide discretion in determining both the amount and the timing of such payments. The staff believes that it is important to retain that discretion and that it would be inappropriate for the staff to propose an arrangement that would simply say that a country did not have to pay until arrears were cleared, which is a matter of judgment for the Board.

With regard to the BIS mechanism, I would simply note that it was intended as a stopgap mechanism to provide an opportunity to consider and move forward on the DRC's SMP while the institutions sought to resolve their differences of view. The BIS arrangement is not an escrow account in which the funds are committed solely to the repayment of obligations to the Fund. They are part of the DRC's reserves, and they can be used by the DRC as it sees fit. Our expectation, of course, is that if the Fund requested it, they would provide the resources to us, as they were already willing to make direct payments to the Fund in the context of the SMP at much larger levels. Perhaps the Legal Department can address that issue more specifically.

Finally, I would note that with regard to the DRC there is no need for an immediate decision now. We will have an opportunity to assess its performance under the SMP, its record of deposits to the account, and the status of where we are with regard to arrears clearance further down the road. The staff has therefore suggested that we can look at that in the context of the next review of the DRC's overdue obligations, which is scheduled for January.

The Deputy Director of the Policy Development and Review Department (Mr. Allen) made the following statement:

As Mr. Collins said, the proposal for IDA grants was contained in joint Bank/Fund documents in late 1998, and the Bank adopted the policy in 1999. The staff reviewed the wording, but it was our understanding that the policy is statement to the effect that other creditors agreed not to make net withdrawals of financial resources could be applied with sufficient flexibility and over an appropriate time period for it to be consistent with the Fund's arrears strategy. The matter was therefore considered and thought through at that time. The issue is now one of whether in practice the two policies are compatible.

The staff representative from the World Bank (Mr. Wilton) made the following statement:

Thank you for the opportunity to respond on the issues related to the DRC and the provision of an IDA grant. Let me preface my remarks by stating that we very much agree with those Board members that have observed that while this may be viewed as “a technical issue” it is nonetheless a very important issue. Our failure to find a solution will impose real costs on the poorest of our clients in crisis torn countries. Let me also assure you that the issue has received the attention of senior management in the Bank. It is a reflection of how seriously we take this issue that I would prefer to read the following statement—which has been agreed Bank management at the senior most level—rather than respond directly to specific questions. I would be glad to come back to any unanswered questions if this would be useful.

The provision of additional and more timely assistance to post-conflict countries, especially those with large arrears to the World Bank and the IMF, has been a difficult policy issue that Bank and Fund staff have been trying to address for many years. As a result of the difficulty in securing domestic and external sources to finance the clearance of high levels of external arrears, opportunities were lost for early engagement of multilateral institutions in contributing to reconstruction. Several joint Bank/Fund Board papers were produced to outline the challenges facing our institutions in providing more timely and effective financial support to these countries and to outline possibilities for early intervention, including the option of IDA grants.

This work led to the limited use of IDA grants for early reconstruction efforts in the pre-arrears clearance period being approved in the context of the IDA 12 replenishment agreement. As noted by Mr. Collins, the Bank has continuously consulted on its approach with Fund colleagues and the key conditions for providing post-conflict grants was described in the joint Bank-Fund paper entitled “Assistance to Post-Conflict Countries and the HIPC Framework.” The framework was formalized in the first IDA post-conflict grant proposal for the Democratic Republic of Congo, approved by the Bank Board on July 31, 2001.

The framework for providing post-conflict grants has now been considered and approved by the Bank Board. As the approved requirements are laid out in the Fund statement that you have before you, I will only emphasize two—namely that IDA grants would only be provided where: (i) arrears to IBRD and/or IDA are large and protracted, and cannot be easily or quickly cleared using domestic resources; and (ii) a concerted international effort to provide positive financial flows and other assistance is underway, and other creditors have agreed not to make net withdrawals of financial resources from the country.

As all five of the criteria must be met, it is clear that the provision of post-conflict grants by IDA is for very exceptional cases. They enable the World Bank to provide assistance where there are extremely scarce resources and a need to move quickly to help consolidate peace, even though the existence of large and protracted arrears precludes Bank lending. The conditions on the extension of IDA grants in this situation are intended to ensure that the exceptional resources provided will be used solely for the purpose of meeting the countries' initial critical recovery needs. Obviously, given that money is fungible achievement of this objective would be impaired if resources were diverted to debt service. In this context, it is important to recall that payments to the IMF from a post-conflict country receiving an IDA grant before arrears clearance would, as several Board members have noted, trigger similar payments to the Bank and AfDB, which would, in turn, further erode the ability of an IDA grant to enhance the government's capacity to fund programs on the ground to help the poor and consolidate peace. In this regard I would note that the proportion that the payment represents of the debt service falling due to any particular creditor is irrelevant. It is the use of the country's resources to make payments rather than finance crisis expenditures that matters.

Keeping in mind the requirement of the IDA post-conflict grant that other creditors do not make a net withdrawal of funds in the pre-arrears clearance period, Bank staff welcomed the compromise proposed by Fund staff in the particular case of the DRC. The Fund proposal was that the government would make deposits into a Congo-controlled account in the BIS as a demonstration of the DRC's intention to make progress towards arrears clearance. Based on the understanding that payments would be deferred until the point of arrears clearance (at which point net Fund financing would be positive) the last remaining requirement for the IDA post-conflict grant for the DRC was met, enabling IDA to present to its Board a post-conflict grant proposal for the DRC. To preserve comparable treatment of preferred creditors, which is an important general principle and part of the IDA post-conflict framework, the DRC was also required to make comparable and proportionate deposits with respect to its World Bank arrears and African Development Bank arrears.

We have been asked to address the issue of the lack of full consistency between the IDA post-conflict grant framework and the repayment policy of the IMF. Let me be clear that Bank staff recognize the importance that the Fund Board attaches to retaining the right to request repayments from a country in arrears. However, we would suggest that, in the case of the DRC, the appropriate and flexible application of this policy would entail deferring direct payments until the arrears clearance point, as reflected in the agreement underlying the Bank Board's approval of the post-conflict grant. We view this approach to be a pragmatic solution that enables both institutions to move

forward with the IDA grant without holding DRC hostage to our considerations. We also very much agree with the Board members that have asked that we work together to define a solution to this issue based on robust principles.

In closing, we would like to stress that the number of countries where IDA post-conflict grants could be provided and where arrears to the Fund exists is very limited. My colleagues from our Department that is responsible for IDA would be happy to provide details on this issue if the Board thinks it is useful.

Mr. von Kleist noted that the DRC's payment to Fund amounted to 0.2 percent of its export receipts. What was the other 99.8 percent being used for, and why could the DRC not use more of its export receipts to repay the Fund?

The staff representative from the World Bank (Mr. Wilton) replied that one of the principles of the IDA grant was that other creditors would not make net negative financing demands on a country that received the IDA grant, no matter how large the financing demands were. In addition, direct payment to the Fund would trigger payments to other preferred creditors. The Fund and the Bank would therefore need to work closely to reach a solution to the problem of reconciling the IDA policy with the Fund's arrears policy.

Mr. Collins asked whether the IDA policy should refer to gross withdrawals and not net withdrawals, as accumulating arrears was in fact a provision of resources by the creditor that was not being repaid.

The Deputy Director of the Policy Development and Review Department (Mr. Allen) replied that, unlike net withdrawals, precluding gross withdrawals would prevent the regularization of relations with creditors during the period covered by the IDA grant disbursement.

Mr. Kiekens noted that any payment to the Fund would have been inconsistent with the IDA policy if it were based on gross withdrawals. The Fund's Balance of Payments Manual treated the restructuring of debts and the occurrence of arrears as an exceptional form of financing. The accumulation of arrears would therefore be considered as additional gross financing. If there were some repayment, the remaining overdue would be considered the additional net financing. However, the IDA did not subscribe to the Fund's interpretation as contained in the Balance of Payments Manual.

Mr. Collins clarified that he was in favor of the approach the World Bank was advocating, although it could be clarified by referring to gross instead of net financing.

Mr. Quarles noted that he agreed with Mr. Collins. As the IDA policy referred to net withdrawals, there did not seem to be any discrepancy between it and the suggestion that the DRC make some form of de minimis payment to the Fund.

Mr. Charleton agreed with Mr. Kiekens and Mr. Collins. If the DRC could not or would not use the money in the BIS account, why then could it not be used for repayment to the Fund, particularly as it was not being used to address the developmental needs of the country?

Mr. Elkjaer made the following statement:

At this stage of the discussion I will limit my comments to the main issues.

First, on the issue of transparency, our chair has consistently argued in favor of increased transparency and there is a need to bring the publication relating to overdue obligations more into line with the Fund's enhanced transparency. I can therefore support the staff's proposal with respect to publish the information on overdue financial obligations at an earlier stage and missed repurchase expectations. I also see merits in Mr. Quarles's suggestion to publish these data with a breakdown on a quarterly basis. Moreover, I also see some merits in Mr. Wijnholds's and Mr. Azoulay's suggestion to publish information related to late payments, and in particular overdue currency valuation adjustment obligations as these are quite large. I believe that publication of such information could be effective in reducing these kinds of overdue obligations.

Second, I also support the extension of the RAP.

Third, I can support the recommendation to strengthen the procedures in cases involving overdue obligations to the PRGF Trust. I would, however, emphasize that the suspension of technical assistance should be limited to cases where the technical assistance is unlikely to lead to a resolution of the overdue obligation to the Trust.

Lastly, turning to the more complex case of the DRC. Our chair firmly believes that payments to the Fund is an integral part of establishing a track record of cooperation with the Fund. The Fund should retain discretion on payments. At the same time the Fund must be flexible in determining the amount of repayments.

I must admit that I am not very happy with the current arrangement of DRC paying into an account in BIS. It is only an interim solution, and it should not lead to precedent. Like others, I am not sure that a repayment by the DRC of less than the accumulation of interest on the arrears can be considered a net withdrawal. In fact, arrears can be considered as involuntary rollovers, and no one would argue that a rollover does not provide financing.

I agree with staff that the Fund should retain the flexibility provided under the arrears strategy, and in the case of DRC the issue of transfer could

be considered at the time of the next review of DRC's financial obligations. However, to make a decision on transfer we need a concrete arrears clearance plan for DRC with respect to the IDA grant element and also address the Fund's concern about repayment as part of good track record. I would urge the Fund staff, together with the Bank staff, to find a solution that is internal Bretton Wood consistent.

Mr. Sdrulevich made the following statement:

We would like to thank staff for a complete and clear paper that sets out very clearly all the relevant issues. I will focus on the proposed decisions, on the Fund arrears policy in reference to the case of Congo DRC, and, lastly, on the problem of the inconsistency between the Fund and the World Bank's policies on arrears.

Let me say at the outset that we agree with the extension of the arrears policy to PRGF resources, and we support the proposed decisions with one exception, regarding the suspension of the provision of technical assistance in the case of a country in PRGF arrears. Given the importance of technical assistance in the framework of the strengthened cooperative strategy, we would prefer that the suspension be applied after a longer period than the one proposed, such as, for example, 12 months.

Turning to the current Fund policy for arrears cases, we agree with other speakers that it has been more successful in the prevention rather than in the resolution of outstanding arrears. In this sense, while we support once again the extension of the RAP approach, we wonder if, looking forward, we will not need a more general revision of the Fund's policy, for two reasons. On one side, the Fund should concentrate its efforts on the most prominent cases of protracted arrears, as just forcefully underlined by Mr. Callaghan. On the other side, an aspect that certainly merits attention is the application of the principle of equality of treatment. As we noted on other occasions, we are particularly troubled by the treatment of Congo DRC in comparison to other arrears cases, particularly those eligible for the RAP program. A comparison of Congo DRC with other past and current countries in arrears shows that equality of treatment is not respected along at least two dimensions. The size of the payments requested to Congo is significantly smaller on all measures. The length of the requested track record is shorter even than the shortest of RAP cases. In particular, compared to that of Sudan the treatment of Congo does not fare well.

Lastly, let me move on to a problem that has been touched by I think all the other speakers, that is, the inconsistency between the Fund and the banks policies towards arrears. I think Mr. Rustomjee has eloquently stressed the need of arrears countries in extreme distress for immediately available resources. Indeed, IDA grants serve exactly this purpose. At the same time,

we fully share Mr. Shaalan's and others' observation that the payments to the Fund are an indispensable element of its policy towards countries in arrears. It is not easy to find a solution to the conflict between these two equally important exigencies. In this sense, the temporary solution found for Congo DRC, while not solving the general problem, is proving useful in this particular instance. In any case, to respect the Fund's policy, the payments of Congo DRC to the BIS account will have to be transferred to the Fund before the arrears conversion.

We have to underline that we do not consider this a model to strictly follow in future cases. Therefore, we encourage the staff of the Fund and the Bank to work together to find a more straightforward solution for those—admittedly relatively few—situations where this problem might arise again in the future. This general solution will have to respect the principle of payments record. Such solution could be, following Mr. Kiekens's suggestion, that the grants by the World Bank be targeted to specific projects, so to be compatible with the payments to the Fund. Another avenue to be explored could be that of the net interest payments raised by Mr. Kiekens and Mr. Collins. We also believe that, absent such solution, a pragmatic case-by-case approach could be taken with the best interest of the concerned countries in mind.

Mr. Al-Turki made the following statement:

Progress has been mixed in addressing the problem of overdue obligations to the Fund over the period covered by this review. The good news is that one country with protracted arrears became current, an agreement on a staff monitored program between the Democratic Republic of Congo and the Fund was reached, and Sudan continues to make progress on payments and policies. However, the emergence of overdue obligations by Zimbabwe and the setback on payments by Liberia are concerns. While there was a small decline in the total amount of overdue obligations to the Fund, these obligations remain large and concentrated in a few difficult cases.

Against this background, I agree that the strengthened cooperative strategy remains appropriate. At the same time, it is clear that the Fund needs to remain vigilant and persist in its efforts to assist countries with overdue obligations to become current. In this connection, I support a further one-year extension of the rights accumulation approach. The emergence of arrears to the PRGF Trust Fund by Zimbabwe also highlights the need to elaborate a clear strategy to deal with such arrears.

Turning to the tension between the Fund's arrears clearance strategy and the conditions governing the extension of IDA grants to post conflict countries in arrears to the World Bank, it is unfortunate that in formulating IDA's policy on this issue, not enough consideration was given to the long

standing arrears clearance strategy of the Fund. In this connection, it is essential that the Fund's policies are not decided outside the institution, and I am encouraged by Mr. Newman's remarks in that regard. While I can go along with the compromise reached in the case of the Democratic Republic of Congo, it is critical that this not be seen as a precedent not only in dealings with IDA, but also in dealings with other multilateral institutions.

On PRGF arrears, I support the proposed procedures detailed in the staff paper. Indeed, they parallel, to the extent possible, the procedures for GRA arrears. I can also go along with the consensus on the proposed publication strategy.

Turning to the proposal on publication of information on missed repurchase expectations, I can go along with the consensus, but I share the doubts and concerns raised by previous speakers about this proposal.

Mr. Wei made the following statement:

First, I would like to thank staff for its well-prepared paper. I agree with others that the Fund's current strategy on overdue financial obligations remains generally appropriate in safeguarding the institution's financial integrity, underpinned by the slightly declining aggregate amount of arrears. In this process, the efforts by the governments of Sudan and the Federal Republic of Yugoslavia and the relevant parties should be appreciated. I am of the view that not only have the preventive and remedial measures played a role in containing and reducing the level of arrears to the Fund, but the measures aimed at encouraging members in arrears to strengthen their cooperation with the Fund have also had an important bearing on the arrears solution. In this regard, the proposal to extend the availability of the rights accumulation program for another year is fully justified.

On the issue concerning the collaboration between the Fund and the World Bank in helping countries in arrears, and payments to the Fund and other creditors by the recipients of IDA grants, the DRC case highlights the compelling need for major international financial institutions to coordinate their own arrears strategies to establish a mutually consistent one. Therefore, I support staff's proposal that the Fund should retain the flexibility provided under the arrears strategy to determine the amount of payment to the Fund as a test of cooperation. Like Mr. Rustomjee, we think the approach applied to DRC appropriate and practical. We also share his comments on the related issues to post conflict countries. Considering the very weak administrative capacity of a post conflict country, it is not realistic to expect the country to meet too many requirements within a short period of time.

The new arrears case of Zimbabwe in the PRGF Trust is really unfortunate. I hope with further efforts on the Zimbabwean authorities' part

and help from the international community, the noncurrent repayment to the PRGF Trust can be solved in a timely manner. Nonetheless, to safeguard the financial soundness of the PRGF Trust instrument, I can go along with the proposed decision to set up strengthened remedial procedures for PRGF arrears in general. Meanwhile, I share the view of Mr. Kelkar in his preliminary statement on the staff proposal to remove a member from the PRGF Trust Fund list if its obligations are overdue for more than six months. Like many others, we are of the view that the punitive measure to cease technical assistance to the country is counterproductive.

As for the proposed change in the publication of information on overdues, the current publication procedures have served the Fund's arrears strategy quite well, and, like Mr. Kelkar and Mr. Shaalan, I don't see the advantages and necessities advocated by staff in such a move.

In the same vein, we have concerns on the proposed publication of missed repurchase expectation. As recognized by staff in paragraph 44, missing repurchase expectation should not be treated as a breach of obligation. I share the concerns Mr. Kelkar and others have expressed on this proposal.

Ms. Bonomo made the following statement:

The situation on the arrears front appears to be broadly stable, with the welcome clearance of outstanding obligations by the Federal Republic of Yugoslavia tipping the balance for a slight reduction in overall arrears. Another positive development is the noteworthy change of attitude of the authorities of the Democratic Republic of the Congo, one of the major arrears cases, and their willingness to renew cooperation with the Fund and to embark on a staff-monitored program. However, of serious concern is the new case of arrears of Zimbabwe, which includes arrears to the PRGF Trust.

Turning now to the policy issues, let me say at the outset that I broadly concur with the propositions set forth by the staff and support the proposed decisions. I just have a few comments.

On the Rights Approach, we have no objections to extending the availability for another year. This should offer the countries that are still eligible for the Approach the additional incentive to resolve their arrears to the Fund. However, as mentioned by Mr. Kelkar and staff, we must of course be aware that further extensions will be necessary, as the cases of Liberia, Somalia, and Sudan are not likely to be solved soon. Another thing that I would like to point out, like Mr. Collins, is the repayment profile to the Fund following the encashment of rights if these countries were actually to be accorded RAPs at some point in the future. Humps in the repayment profile should be avoided, if we want to avoid the rather unpleasant procedures the

Board went through when discussing assistance to Zambia under the HIPC Initiative, and I am glad that staff is aware of this problem.

Moving on to the question that has recently arisen over IDA payments to members with overdue obligations to the Fund, we believe that, as a matter of principle, the problem should be addressed from the perspective of what is best for the country in question. It would be unfortunate if second best were achieved merely for regulatory reasons. Having said this, we fully agree that repayments to the Fund constitutes a decisive element of any effort to improve cooperation with the Fund and other donors. Changes to the practice of demanding payments from countries on their way to clearing overdue obligations would put into question the entire arrears clearance strategy of the Fund. It makes good sense in principle to tie IDA grants to countries in arrears to a standstill on payments to other creditors. It should, however, be possible to interpret this prescription with some flexibility in the case of payments to the Fund. Indeed, as staff puts it, the transfer of resources should be looked at from a long-term perspective. Moreover, a solution that would allow payments to the Fund could be to interpret net withdrawals in the way proposed by Mr. Quarles and Mr. Kiekens. The issue should be resolved without undue delay, in order to avoid such cumbersome procedures as undertaken with the DRC's payments. This would imply that it was taken up by the Bank's Board soon again.

Furthermore, I very much welcome the proposition to complement the existing remedial measures for cases of arrears to the PRGF Trust by a timetable of procedures similar to the one applied for overdue payments to GRA. This will ensure the necessary clarity in cases in which only PRGF Trust Fund resources are involved.

Finally, I also think that it is important that missed repurchase expectations will be communicated as proposed by staff and I support the respective decision.

Mr. Maino made the following statement:

Like many other chairs, we would like to thank staff for the well-written document advanced for today's discussion. In general, our current strengthened cooperative strategy to deal with members in arrears is working. In particular, prevention should remain the first line of defense against the emergence of new cases of arrears. Also, close consultation and some flexibility, on a case-by-case basis, are essential to help find satisfactory solutions for those members who are already in arrears to the Fund. However, as Mr. Kiekens has already mentioned, Zimbabwe's outstanding arrears to the Fund bring to the fore the differences in the procedures applicable to PRGF arrears with those already contemplated in the GRA.

We are encouraged by the progress made by the Democratic Republic of Congo to meet its obligations with the Fund under a staff-monitored program, including the agreed monthly payments of SDR 100,000 to an account that the DRC established with the Bank for International Settlement (BIS) last June.

We understand World Bank staff's concern regarding the use of IDA grant resources, oriented to reconstruction needs, to pay debt service to other creditors. However, the Fund staff is also right in underscoring the need to look onto the medium-term perspective and to adopt further flexibility should other circumstances arise. We fully concur with the views expressed in paragraph 29 of their report and in the staff update. We commend the Bank and the Fund management and staff for finding a creative mechanism to overcome this difficulty by allowing the DRC to make deposits into an escrow account in the BIS. This case proves that close cooperation between both institutions can serve to broaden the interests of the membership as was stressed by the World Bank representative during this meeting. We agree with staff's recommendation that the next review of the DRC's arrears or the completion of the staff-monitored program would afford the Board a suitable occasion to assess the progress made. Furthermore, we welcome Mr. Rustomjee's suggestion to undertake further work exploring innovative ways for resolving the problem of protracted arrears cases.

Our comments on the proposed decisions are provided in the same order as presented in the staff report.

Concerning the extension of the Right Accumulation Program (RAP), we support Decision No. 1 to extend the rights approach through end-August 2002. This program offers a unique mechanism for countries in protracted arrears to build a track record while an adequate external financing is in place, including the bridge loans to clear arrears.

We can go along with Decision No. 2 to equalize procedures in the event of arrears to the GRA and PRGF Trust, as explained in Annex II, with one caveat: arrears should be reported to the public only after six months, regardless of whether it is in the form of a press release or a brief factual statement to be posted on the member's country-specific page on the Fund's external website.

We consider that the Fund's current practice of waiting months before publishing information on arrears has worked well and should be continued. As staff notes in paragraph 37, the current policy was adopted to avoid reporting short-term arrears arising from technical difficulties and to furnish the member with enough time to meet its obligations. In addition, such members may also be in the process of negotiating a new Paris Club or

rescheduling arrangements with other creditors, and that usually takes more than three months before a formal agreement is reached.

Thus, this is not a matter of transparency, which we strongly support, along the lines already mentioned today by Mr. Quarles. Rather, it implies the use of a pragmatic and positive approach to help a country in arrears find a cooperative solution. Flexibility, as mentioned by Mr. Yanase, is key, and in our view, a first best option. More specifically, suspension of technical assistance to countries in arrears would be highly counterproductive, since the latter constitutes the mechanism through which countries build up a tracking record and clear arrears.

For the above reasons, we have reservations regarding proposed Decision No. 3. Our Chair, nevertheless, will go along with the majority view on this issue.

On the policy to publish information on missed repurchase expectations, as staff rightly notes in paragraph 44, the Executive Board is sensitive to the concern that missed early repurchase expectations not be treated as a breach of obligation to the Fund. As it was extensively brought out in previous Board meetings, the key is to provide positive incentives to members as opposed to just punitive or remedial measures. The inability of a member to meet an early repurchase expectation does not represent noncompliance or a problem with the design of the program. Moreover, it could be evidencing that the country is recovering in line with the normal period envisaged under the arrangement.

The adverse market reaction that would inevitably accompany publication of a missed early repurchase expectation or extension complicating the process of adjustment of a member that would otherwise be in compliance of a Fund-supported program suggests the desirability of highlighting through routine publication, including in the Fund's website, only the cases where early repurchase expectations are met. This corresponds to the concept of positive incentives that should guide this policy. In any event, as staff recognize, the Fund already publishes routinely a wide range of country-specific information, including repurchases falling due according to the early expectations schedule. Thus, markets are appraised of this information and there is no need to "highlight" that a member is not performing better than envisaged in the program approved by the Executive Board. It goes without saying that if an actual repurchase obligation were missed, the policies outlined in the previous decision would apply. Accordingly, we do not go along with Decision No. 4.

Finally, we can support Decision No. 5 to update a cross-reference in the PRGF Trust Instrument.

Mr. Low made the following statement:

I will try to be brief, and note that most of our views are quite closely aligned to those expressed by Mr. Kelkar and Mr. Shaalan in their statements.

With respect to the rights approach, we agree to the extension, and I think Mr. Kelkar raised a valid question, and the staff has tried to answer that.

On the procedures to address overdue financial obligations, we also share his view that there is no necessity to declare PRGF-ineligible those countries that have arrears to the PRGF Trust, because I think the criteria for PRGF eligibility should be based solely on macroeconomic and poverty reduction considerations, not on arrears.

On the issue of technical assistance (TA), I think that has been raised before, and we also share the views of others that there is no reason to withhold technical assistance, especially any TA meant to strengthen a country's capacity to repay.

On the issue of publication, I think this is one area where I would like to delve a little bit more. Here the staff has given the rationale for reducing the period for publication to three months in order to achieve greater transparency. We believe, as we have stated before, and we reiterate again, that transparency is not an end in itself. We are not here to achieve absolute transparency, because if that is the case, then there are a lot of ramifications, even to the Board itself. We have to address it from the point of view of what do we hope to achieve by reducing the period before publication from six months to three months, and I have not seen that addressed. I would have thought that the rationale would be to serve the interests of the member countries, and here I am not sure whether that it is in the best interests of members to have the publication shortened to three months. The staff has rightly pointed out that the intention is not to publish temporary arrears or those that have technical difficulties, and if that is the case why do you need to shorten it to three months?

The other rationale presented by the staff was that moving from six to three months would not be in breach of International Accounting Standards. I would ask the question the other way: does the current procedure breach International Accounting Standards? If not, why do you need to change it? So I am not convinced that there is a good rationale for bringing the publication closer to three months because I think all of us know how long it takes for a country to resolve its own difficulties for whatever reason and meet its repayment expectations. Therefore, from that point of view, I share the same views that have been expressed by Mr. Kelkar, Mr. Shaalan, and most recently by Mr. Maino on the publication issue.

Similarly, we talk about publication of missed repurchase expectations on the basis that this leads to greater transparency. However, we have to ask ourselves what do we intend to convey by publication? As many have mentioned and even the staff has admitted, missed repurchase expectations is not the same as breaching obligations. So, why do we have to highlight to the whole world that a country has missed some expectations? I fear that publicizing such information in light of the greater attention that has been paid to information provided by the Fund through press releases and such might cause markets to misinterpret that there is some form of sanction being imposed on a country even though some qualification is provided that this is not a breach of obligations. Nevertheless, markets may misinterpret whatever we publish, so I have quite a bit of concern if you were to proceed and highlight missed repurchase expectations.

The Acting Chair (Mr. Aninat) noted that the difference between a missed repurchase expectation and a breach of obligation would be made abundantly clear in the document before it was published.

Mr. Beauregard made the following statement:

We thank the staff for preparing the paper for today's discussion. At the outset a country's fulfillment of obligations is key to maintain a normal relationship with the Fund, and we encourage those countries at risk to regularize their relations. We can support the staff's decisions, but with two exceptions.

On PRGF countries, as other Directors feel, we think that technical assistance to those member countries with arrears is crucial and will enhance their ability to repay to the Fund.

We also support those Directors that raised the issue that missed repurchase expectations should not be treated as a breach of obligations to the Fund, and like we mentioned before, we think parallels with arrears procedures are not appropriate. Given that repurchase expectations will be met only if a member country's external position has been stronger than originally projected, we think that in many, if not in most cases, a missed repurchase expectation could be a situation not in the control of the country authorities. In this sense, we do not support the publication of missed repurchase expectations as this information could be misinterpreted as the member country having fallen into arrears, when the fact is that the member's external position is simply not stronger than expected. As Mr. Callaghan, we think there is not a clear enough differentiation between member countries that missed repurchase expectations and those that failed to meet their obligation with the Fund on time.

Extending his remarks, Mr. Rustomjee made the following statement:

I wanted to just come back to the staff on a few issues, some of which we raised in our statement, and some of which have arisen through the discussion. The first was an issue more in the way of a question we raised in our statement, which was connected to the proposal that countries that are in protracted arrears to the PRGF Trust could become ineligible for the PRGF Trust Fund. Our question was what is the process for restoring PRGF eligibility. In the GRA scenario a sort of a de-escalation timetable for punitive measures exists. However, we are not quite sure what will be the process under the PRGF. I think it will be important that we have clarity on that if we are going to institute such a policy. I would be grateful for any comments from the staff on that.

On the series of other issues, first on the issue of the RAP, I heard the staff's comments very carefully, and we do accept the comments of the staff on the need for the flexibility that is already apparent in the RAP timetable process. We do feel that flexibility needs to be applied, and in the case of the protracted arrears cases we would urge two things. One is that when they do embark on RAPs, that maximum flexibility is afforded and second, that for those countries that embark on RAPs and/or staff-monitored programs as well incidentally, that these count toward the track record for HIPC relief. We feel this is really crucial. We unfortunately reiterate it every time we discuss RAPs or SMPs, but we feel very, very passionately that the track record really ought to count. I think we are grappling with one manifestation of very, very profound poverty when we see countries that are in protracted arrears. Often it is not entirely by the making of the policymakers themselves, and if it is, sometimes it is the making of policymakers who have long gone and then sometimes democratic governments enter, and they grapple with the consequences of the poor policies of the past in some cases, and we feel that when countries do seriously embark on RAPs, and they go through all the stages that are necessary to be accorded recognition for going through a RAP that that track record ought to count toward HIPC-Initiative assistance.

We also feel that on the issue of technical assistance (TA) that we had raised, and I am glad to see that there is quite considerable support for it, that TA should not be denied to cases of protracted arrears to the PRGF Trust Fund. We feel there are two particular reasons why TA should not cease in the manner proposed by the staff, and that the presumption should be that TA will continue, but that of course there is always discretion as Mr. Callaghan and a number of others raised, where the staff could stop TA.

The first is that if the intention is to admonish a PRGF-eligible country by stopping TA, I am not really sure that will actually do much. The second is that if the intention is to save on TA resources, we feel that the paper that staff produced in October last year on the annual review of TA, which I think we

discussed in January, contains enough safeguards on the use of TA to avoid a situation where PRGF countries that are in arrears will use TA in an irresponsible way and waste valuable TA resources. In that document I recall there are nine safeguards that the staff has the opportunity to use to decide whether a country should or should not receive technical assistance. They are quite comprehensive safeguards and explicitly recognize the needs of countries that are using PRGF resources and that are post conflict, and I think they provide adequate basis for the staff to judge whether a country is or is not using TA effectively.

On the issue of innovation, we had suggested in our statement that the countries that have been in protracted arrears, such as Liberia and Sudan, make up, I think, 75 percent of everything we are discussing today. We said in our statement that at a certain point it may be appropriate to have some kind of a pause, some kind of a temporary cutoff where we say, well, all the accumulation of interest and accumulation of penalty interest stops for a window of opportunity to try and find an innovative resolution for these individual protracted arrears cases, which if it works, works for the benefit of the Fund. If it does not, we simply return to the continuation of the previous process.

We feel that when we look at countries that fell into arrears many years ago and now quite literally have more interest due to the Fund than the original principal amount, we must be getting to a situation where we call into question whether our arrears strategy is working in those cases, and we feel that the idea of using a window of opportunity is an appropriate one to raise at this point. Our suggestion would be for the staff to consider in the next perhaps three to four months, certainly in our view not another year, preparing a short paper that simply outlines some of the innovative ideas that could be put on the table. I must be quite candid, I think it will require additional resources, and I think that is inevitable. I think that the Deputy Treasurer was quite upfront in saying that one of the reasons why we are not making a breakthrough of the kind that we would like is that there is a resource constraint. But, certainly I think some innovation would be warranted. We feel that it would be useful if the staff were to prepare a brief paper after consulting with various departments in the Fund, and perhaps three or four particularly interested industrial countries, three or four maybe African countries that may have an interest in being part of a solution to the individual arrears cases, and the countries concerned, and then circulate it for comments. We feel that in the absence of some kind of innovation, we are actually not going to crack this issue, and we are going to have a situation where we have one group of prolonged, protracted arrears cases, and one other group of all the others that are exiting the process because the rest of our policies are working well.

Mr. Yanase noted that at the six-month stage of arrears the Board had the discretion to decide whether or not to suspend technical assistance to a member. Furthermore, at the twelve-month stage the Board would have to decide whether or not to issue a declaration of noncooperation as well as decide again whether or not to suspend TA. It was reasonable to assume that if a country were deemed to be noncooperating, the Fund would suspend its TA to that country.

Mr. Charleton supported Mr. Rustomjee's for an innovative approach or paper to address the situation of those case countries with large, protracted arrears to the Fund.

Mr. Yépez made the following statement:

We would like to thank the staff for a well-focused paper on the strategy on overdue financial obligations. The Fund's policy has been effective in preventing the emergence of new cases of arrears and in the progress of intensified collaboration. In fact, the number of countries in protracted arrears to the Fund declined from seven to six in the last year. Sudan, which accounts for almost half of the total arrears, continues to make significant progress in improving relations with the Fund and the number of members incurring in late payments to the Fund has decreased consistently in the last ten years. However, given the length of protracted arrears, we would like to associate ourselves with Mr. Rustomjee's proposal to find innovative and proactive ways for the Fund and other institutions to expedite plans for the clearance of arrears.

We support the proposal for the extension of the Rights approach through end-August 2002, since there are three countries that are eligible for the rights accumulation program and share most of the protracted overdues to the Fund.

The recent case of Zimbabwe, as the first country with protracted arrears to the PRGF trust, calls for establishing procedures similar to those related to GRA arrears. In that direction, we can also support the recommendations to strengthen procedures in cases involving overdue financial obligations to the PRGF trust. Technical assistance is crucial for the implementation of good macroeconomic policies that enhance the potential of PRGF countries to meet their external obligations. In this vein of thought, we cannot go along with the proposal to suspend technical assistance after arrears have been outstanding for more than six months.

Regarding publication of information on arrears, we concur with several Directors in the sense that missed repurchase expectations cannot be treated as a breach of obligations to the Fund. We consider that there is no need to make public such events.

On payments to the Fund in cases of arrears, we agree with staff that payments made by a member to the Fund to reduce accumulation of arrears are an important demonstration of cooperation on the Fund's strategy on overdue financial obligations. In the case of the Democratic Republic of Congo, this policy is inconsistent with World Bank policies regarding the use of IDA grants. A temporary solution has been adopted with the deposits made in the BIS in lieu of direct payment to the Fund. Although the transfer of resources from this account to the Fund will be discussed at the beginning of next year, we are in favor of finding a solution that allows the use of grants by the country that will help in the efforts of reconstruction and stabilization.

Mr. Callaghan supported the proposal of Mr. Rustomjee for a paper describing innovative approaches to solving the problem of large, protracted arrears cases.

Mr. Zakharchenkov made the following statement:

I wish to indicate that we share the staff's position on the main policy issues as presented in the paper and further clarified during the discussion, and we support the proposed decisions.

Mr. Azoulay also supported the proposal to consider innovative ideas for dealing with protracted arrears cases.

The Deputy Treasurer (Mr. Newman) made the following statement:

Mr. Rustomjee asked a specific question about how does a country get to be put back on the PRGF eligibility list. The basic answer is that the Board has to take a decision, but as a practical matter and consistent with the Fund's policy of no lending into arrears, it would also require that the arrears be cleared, which is basically the same kind of policy that we have with the removal of the declaration of ineligibility in GRA cases.

Several Directors have expressed concern, again, about the missed repurchase expectations and differentiating them from failure to meet financial obligations through arrears. We agree that it is important to make such a distinction, and what we will do first, as the Acting Chair said, is clarify it further in the paper, and if there is also agreement on publication, we would also ensure that any notice on the Fund's web site would also make abundantly clear that a missed repurchase expectation is different from an arrears case. We would note, however, that on the issue of publication the staff will be putting on the web site the schedule of repurchase expectations and the schedule of obligations, and a skilled reader of the Fund's finances will be able to divine when there are missed repurchase expectations. The purpose of the proposed transparency is to enable those who may not be as familiar with the arcane nature of the Fund's finances to be on a level playing field with the more knowledgeable observers.

With regard to publication of arrears at three months, I would simply note that our experience has been that technical arrears cases can be resolved and normally are resolved within less than three months. Once we get to the three-month point it is almost certain that we are going to get to the six-month point. Again, as experienced readers of the Fund's accounts can determine when an obligation has been missed, it was really for the purposes of transparency and providing others with information on arrears at the three-month point that we had proposed publication.

A question has been raised about the accounting treatment. I think there is a distinction between publicizing an event and how you treat it in your financial accounts. When we do the six-month provision in the financial accounts, it basically means that we move a country from an accrual status to a cash status, and that has certain implications for how one presents accounts, and in the context of the Fund it also has implications for the burden-sharing arrangements. A number of international financial institutions do the accounting change at the six-month mark. Private institutions, including some commercial banks, do it at the three-month or the six-month mark. The staff had proposed to retain the six-month treatment for accounting purposes and burden-sharing purposes, but to simply inform the public about the existence of the arrears at the three-month mark when it is no longer likely to be a technical issue.

Let me turn to the question of technical assistance before I come back to Mr. Rustomjee's broader issues about the arrears strategy per se. As I mentioned earlier, under the current policies on arrears the Board retains its discretion as to whether to continue, to suspend, or to reinstate a country's technical assistance, and our intention in the PRGF case was simply designed to duplicate that policy. We have heard Directors' desire to make it clearer that there is no automaticity to the process and we will propose some changes in the policy to achieve that, and I gather there is a large body of opinion that consideration of what you do about technical assistance should occur at the 12-month mark, which is after the declaration of noncooperation rather than at an earlier stage in the process.

The Acting Chair (Mr. Aninat) observed that the Board was in favor of considering suspending the provision of technical assistance to PRGF-ineligible countries only after they were in arrears for twelve months, not six months as the staff had originally proposed, and only once a declaration of noncooperation had been issued.

Mr. Yanase asked whether the presumption was that technical assistance would be continued to be provided unless the Board decided otherwise.

The staff representative from the Legal Department (Mr. Elizalde) replied that after a country had been in arrears for twelve months, the Board would decide whether or not to suspend the provision of technical assistance.

The Deputy Treasurer (Mr. Newman) noted that the arrears strategy provided sufficient flexibility on the length of a RAP and the enhanced HIPC Initiative provided sufficient flexibility with regard to determining appropriate track records in particular cases.

Suspending the imposition of interest charges on overdue obligations would deplete the resources in the PRGF Trust as creditors would expect to receive their remuneration, the Deputy Treasurer explained. However, the accumulation of deferred charges, particularly under the current burden sharing arrangements, had not hampered the Fund's ability to address the arrears problems of the protracted countries, as donors had often provided the necessary resources.

The Acting Chair (Mr. Aninat) noted that the Board agreed with Decisions Nos. 1, 2, 3, and 5.

What were Directors' views on Decision No. 4 regarding publication of missed repurchase expectations, the Acting Chair asked.

Mr. Beauregard noted that the circumstances that caused cases of missed repurchases expectations were often outside of the control of authorities. As such, there was not much benefit in publishing this information, particularly given the danger that markets might misinterpret it.

The Deputy Treasurer (Mr. Newman) noted that a repurchase expectation could be extended if the Board decided that a country's balance of payments had not improved much faster than was originally anticipated. A missed repurchase expectation only occurred when the Board decided not to provide an extension. In reality, there would be very few cases of missed repurchase expectation as such an event would require that a country's balance of payments situation had not improved much faster than expected, and that the Board decided not to grant an extension. Experience suggests that the Board was mindful of the need not to exacerbate the problems of a country that had experienced some financial difficulties.

Mr. Maino agreed with Mr. Beauregard.

Mr. Rustomjee agreed with views of Messrs. Maino and Beauregard. Furthermore, any decision on missed repurchase expectations should not be taken in the context of a discussion of overdue financial obligations, as that could further reinforce the link Directors were anxious to avoid creating.

The Acting Chair (Mr. Aninat) noted that any public information on missed repurchase expectations would make it clear that there had been no breach of obligation and that no arrears had been accumulated.

The Acting Chair (Mr. Aninat) noted that a majority of the Board was in favor of Decision No.4.

Mr. Low remarked that he had reservations about making information on missed repurchase expectations public.

Mr. Bakhache associated himself with the comments of Messrs. Low, Rustomjee, Maino, and Beauregard on the issue of missed repurchase expectations.

Mr. Yépez noted that there was no need to make information on missed repurchase expectations public.

Ms. Bonomo remarked that she was in favor of Decision No. 4.

Mr. Rouai reiterated his reservations to Decision No. 4.

Mr. Kelkar also reiterated his reservations to Decision No. 4.

Mr. Weisman supported Decision No. 4 with the caveats previously mentioned.

Mr. Liu reiterated his reservations to Decision No. 4.

The Secretary (Mr. Anjaria) observed that there was still a significant majority of the Board in favor of Decision No. 4.

Mr. Yanase suggested that the staff paper should be revised to accommodate Mr. Rustomjee's concerns.

The Acting Chair (Mr. Aninat) agreed with Mr. Yanase.

Mr. Yanase supported Decision No. 4.

The Acting Chair (Mr. Aninat) remarked that Decision No. 4 was approved.

The Deputy Treasurer noted that before the staff paper could be published it would have to be revised to remove references to countries that had accumulated arrears but fell short of the three-month stage.

In addition, the paper would also have to be revised in light of the Board discussion of the Fund's and the Bank's policies on arrears.

The Acting Chair (Mr. Aninat) observed that management also had to decide on some rewording regarding the IDA grant and ongoing Fund/Bank discussions in that regard.

Mr. Callaghan remarked that any country references with regard to overdue currency valuation adjustment obligations should also be deleted.

The Acting Chair (Mr. Aninat) noted that the revised document would be circulated to the Board under the presumption that it would be published.

The Acting Chair made the following summing up:

Directors have taken several decisions to strengthen the Fund's strategy on overdue financial obligations. In this context, they have had a broad ranging discussion of the problems facing post-conflict countries in arrears to the Fund, the World Bank, and others, in which they have emphasized in particular the need for continued cooperation and coordination between the Fund and the World Bank. In addition, a number of Directors stressed the need to actively consider exploring innovative solutions for the small number of countries with protracted arrears, noting that in some of these cases outstanding interest is exceeding principal.

Directors reiterated that payments by members in arrears to the Fund are a key element of establishing a track record in the pre-arrears clearance period. Consistent with its character as a monetary institution with revolving resources, the Fund normally expects members in arrears to make payments at least sufficient to stabilize arrears during the pre-arrears clearance stage, and considers such payments to be an important test of cooperation with the Fund.

In post-conflict cases with protracted arrears, Directors stressed the need to continue to apply the Fund's policy on arrears in a flexible manner that takes full account of the member's policy performance, payment capacity, and efforts to clear arrears to the Fund. In the case of the Democratic Republic of the Congo (DRC), Directors noted that, in lieu of immediate payments, the DRC would deposit the equivalent of SDR 100,000 per month into an account with the Bank for International Settlements as an interim measure. These resources could be transferred to the Fund to meet the DRC's obligations to the Fund at such time as the Fund may request. Most Directors agreed that this arrangement was an exceptional measure appropriate to the circumstances of the DRC that did not set a precedent for the handling of overdue obligations in the case of other countries with different circumstances. Some Directors considered that similar deposit arrangements could prove useful on a case-by-case basis for post-conflict countries receiving IDA grants, with deposits to such accounts considered as part of establishing a track record, and with payments to the Fund deferred until arrears are cleared. Some other Directors questioned the interpretation that payments to the Fund well below accumulating overdue obligations conflict with the condition linked to IDA grants that other creditors make no net withdrawals of financial resources from the country.

Directors agreed that the Fund would consider requesting the transfer of the amount accumulated by the DRC in the account with the BIS at the next review of the DRC's overdue financial obligations with the Fund, scheduled to take place by mid-January 2002 but no later than the completion of the

staff-monitored program scheduled for March 2002. This consideration would be based on the DRC's performance on policies, its record in making deposits, efforts to mobilize support for arrears clearance, and the possible implications for repayments to other creditors, especially AfDB and World Bank, as well as for the IDA grant itself.

Directors encouraged the staff to continue their close collaboration with Bank staff on addressing the needs of post-conflict arrears countries. The staff will consider the suggestions made today on the ways in which the frameworks within which the Fund and the Bank deal with post-conflict arrears cases can be better harmonized, taking into account the suggestions on the appropriate measure of net transfers.

Mr. Elkjaer noted that he would have preferred deleting the words "different circumstances", as they were unnecessary.

The staff representative from the Legal Department (Mr. Elizalde) noted that the case of the Democratic Republic of Congo was setting a precedent, and that under the principle of uniformity of treatment, other members could cite it as a precedent until the Fund changed its policy in that area.

Mr. Collins asked whether the DRC would be required to transfer money from the BIS account immediately if the Board so decided at the time of the next Board review of the DRC's arrears, or whether it could make the payments over a period of time.

The Deputy Treasurer replied that it would be up to the Board to decide on both the magnitude and the timing of any payment.

Mr. Collins inquired why the summing up only addressed a part of the Board discussion.

The Acting Chair (Mr. Aninat) replied that it was his understanding that the rest of the Board discussion was embodied in the decisions.

Mr. Collins requested that the proposal of Mr. Rustomjee, which was supported by several Directors, that the staff attempt to come up with some innovative solutions for those countries with large, protracted arrears be referred to in the summing up.

The Acting Chair (Mr. Aninat) remarked that there had not been a formal commitment to produce a paper on that subject.

Mr. Collins asked that the request of several Directors for such a paper be included for the record.

The Executive Board took the following decisions:

Strengthened Cooperative Strategy—Review

The Fund has reviewed progress under the strengthened cooperative strategy with respect to overdue obligations to the Fund as described in EBS/01/122 (7/23/01). The Fund reaffirms its support for the strengthened cooperative strategy and agrees to extend the availability of the rights approach until end-August 2002. (EBS/01/122, 7/23/01)

Decision No. 12544-(01/84), adopted
August 22, 2001

Procedures Applicable to PRGF Trust

The Instrument to Establish the Poverty Reduction and Growth Facility annexed to Decision No. 8759-(87/176) ESAF shall be amended by adding the following Appendix:

“APPENDIX II

Procedures for Addressing Overdue Financial Obligations to the Poverty Reduction and Growth Facility Trust

The following procedures aim at preventing the emergence or accumulation of overdue financial obligations to the Poverty Reduction and Growth Facility Trust (the “Trust”) and at eliminating existing overdue obligations. These procedures will be implemented whenever a member has failed to make a repayment of principal or payment of interest to the Trust (“financial obligation”).

1. Whenever a member fails to settle a financial obligation on time, the staff will immediately send a cable urging the member to make the payment promptly; this communication will be followed up through the office of the Executive Director concerned. At this stage, the member’s access to the Fund, including PRGF and HIPC resources, will have been suspended.

2. When a financial obligation has been outstanding for two weeks, management will send a communication to the Governor for that member stressing the seriousness of the failure to meet obligations to the Trust and urging full and prompt settlement.

3. The Managing Director will notify the Executive Board normally one month after a financial obligation has become overdue, and will inform the Executive Board of the nature and level of the arrears and the steps being taken to secure payment.

4. When a member's longest overdue financial obligation has been outstanding for six weeks, the Managing Director will inform the member concerned that, unless all overdue obligations are settled, a report concerning the arrears to the Trust will be issued to the Executive Board within two weeks. The Managing Director will in each case recommend to the Executive Board whether a written communication should be sent to a selected set of Fund Governors, or to all Fund Governors. If it were considered that it should be sent to a selected set of Fund Governors, an informal meeting of Executive Directors will be held to consider the thrust of the communication. Alternatively, if it were considered that the communication should be sent to all Fund Governors, a formal Board meeting will be held to consider a draft text and the preferred timing.

5. A report by the Managing Director to the Executive Board will be issued two months after a financial obligation has become overdue, and will be given substantive consideration by the Executive Board one month later. The report will request that the Executive Board limit the member's use of PRGF Trust resources. A brief factual statement noting the existence and amount of arrears outstanding for more than three months will be posted on the member's country-specific page on the Fund's external website. This statement will also indicate that the member's access to the Fund, including PRGF and HIPC resources, has been and will remain suspended for as long as such arrears remain outstanding. A press release will be issued following the Executive Board decision to limit the member's use of the PRGF Trust resources. A similar press release will be issued following a decision to lift such limitation. Periods between subsequent reviews of reports on the member's arrears by the Executive Board will normally not exceed six months. The Managing Director may recommend advancing the Executive Board's consideration of the reports regarding overdue obligations.

6. The Annual Report and the financial statements will identify those members with overdue obligations to the Trust outstanding for more than six months.

Removal from the list of PRGF-eligible countries

7. When a member's longest overdue financial obligation has been outstanding for six months, the Executive Board will review the situation of the member and may remove the member from the list of PRGF-eligible countries. Any reinstatement of the member on the list of PRGF-eligible countries will require a new decision of the Executive Board.

The Fund shall issue a press release upon the decision to remove a member from the list of PRGF-eligible countries. A similar press release shall be issued upon reinstatement of the member on the list. The information

contained in such press releases, where pertinent, shall be included in the Annual Report for the year concerned.

Declaration of noncooperation with the PRGF Trust

8. A declaration of noncooperation with the PRGF Trust may be issued by the Executive Board whenever a member's longest overdue financial obligation has been outstanding for twelve months. The decision as to whether to issue such a declaration would be based on an assessment of the member's performance in the settlement of its arrears to the Trust and of its efforts, in consultation with the Fund, to follow appropriate policies for the settlement of its arrears. Three related tests would be germane to this decision regarding (i) the member's performance in meeting its financial obligations to the Trust taking account of exogenous factors that may have affected the member's performance; (ii) whether the member had made payments to creditors other than the Fund while continuing to be in arrears to the Trust; and (iii) the preparedness of the member to adopt comprehensive adjustment policies. The Executive Board may at any time terminate the declaration of noncooperation in view of the member's progress in the implementation of adjustment policies and its cooperation with the Fund in the discharge of its financial obligations.

Upon a declaration of noncooperation, the Fund could also decide to suspend the provision of technical assistance. The Managing Director may also limit technical assistance provided to a member, if in his judgment that assistance was not contributing adequately to the resolution of the problems associated with overdues to the Trust.

The Fund shall issue a press release upon the declaration of noncooperation and upon the termination of the declaration. The information contained in such press releases shall be included in the Annual Report(s) for the year(s) concerned." (EBS/01/122, 7/23/01)

Decision No. 12545-(01/84), adopted
August 22, 2001

The Executive Board took the following decision on the Amendment to Procedures for Dealing with Members in Arrears, with abstentions from Messrs. Djojotubroto, Kelkar, Shaalan, and Wei:

In the Procedures for Dealing with Members with Overdue Financial Obligations to the Fund adopted by the Executive Board on August 17, 1989,

(i) the title of the decision shall be amended to read: "Procedures for Dealing with Members with Overdue Financial Obligations to the General Department and the SDR Department";

(ii) the following paragraphs shall be added between the paragraph beginning with the terms “A complaint by the Managing Director...” and the paragraph beginning with the terms “The Annual Report and the financial statements...”:

“When a member has overdue financial obligations outstanding for more than three months, a brief factual statement noting the existence and amount of such arrears will be posted on the member’s country-specific page on the Fund’s external website. The statement will be updated as necessary. It will also indicate that the member’s access to the Fund, including PRGF and HIPC resources, has been and will remain suspended for as long as arrears remain outstanding.

A press release will be issued following the Executive Board’s decision to limit the member’s use of the general resources or, if the member has overdue obligations in the SDR Department, to suspend its right to use SDRs. A similar press release will be issued following a decision to lift such limitation or suspension.”; and

(iii) the following paragraph shall be added between the paragraph beginning with the terms “A declaration of censure or noncooperation would come as an intermediate step...” and the paragraph beginning with the terms “A draft of the declaration is set out...”:

“Upon a declaration of noncooperation, technical assistance to the member will be suspended unless the Executive Board decides otherwise.”
(EBS/01/122, 7/23/01)

Decision No. 12546-(01/84), adopted
August 22, 2001

The Executive Board took the following decision on Policy to Publish Information on Missed Repurchase Expectations in Credit Tranches and Under Extended Fund Facility, Contingency Financing Facility, Supplemental Reserve Facility, and Contingent Credit Line, with abstentions from Messrs. Djojosebroto, Kelkar, Mirakhor, Oyarzábal, Portugal, Rustomjee, Shaalan, Wei, and Zoccali.

When a member has failed for three months to meet a repurchase expectation under paragraph 1(b) of Decision No. 5703-(78/39), paragraph 10(a) of Decision No. 4377-(74/114), or paragraphs 6(b) or 19 of Decision No. 11627-(97/123) SRF/CCL, a brief factual statement noting such failure and the resulting suspension of use of Fund resources will be posted on the member’s country-specific page on the Fund’s external website. This

statement will be removed when the Executive Board lifts the suspension, or if the member meets the missed repurchase expectation or settles the associated repurchase obligation. (EBS/01/122, 7/23/01)

Decision No. 12547-(01/84), adopted
August 22, 2001

The Executive Board took the following decision:

Amended Decisions

1. References in Fund decisions to Decision No. 7842-(84/165) on the guidelines on corrective action in cases of misreporting and noncomplying purchases in the General Resources Account shall be understood to be references to Decision No. 12249-(00/77), July 27, 2000.

2. Decision No. 7931-(85/41), March 13, 1985, and Decision No. 7999-(85/90), June 5, 1985 are hereby abrogated. (EBS/01/122, 7/23/01)

Decision No. 12548-(01/84), adopted
August 22, 2001

3. KINGDOM OF THE NETHERLANDS—ARUBA—2001 ARTICLE IV CONSULTATION

The Executive Directors considered the staff report for the 2001 Article IV consultation discussions with the Kingdom of the Netherlands—Aruba (SM/01/241, 8/2/01; and Cor. 1, 8/20/01). They also had before them a statistical appendix on Aruba (SM/01/243, 8/2/01).

Mr. Wijnholds submitted the following statement:

The authorities concur with the broad thrust of the staff's recommendations, and thank them for the thorough and well-balanced analysis of both the achievements and the remaining challenges for the Aruban economy.

Aruba stands out as a positive example of an economy where the Fund's surveillance has a significant impact. The central bank, for instance, is presently already preparing an action plan to implement recommendations made by the mission. Also, given some of the shortcomings that still exist in certain data categories, the report serves as an authoritative document describing the state of the economy (the Fund's numbers are an important part of the official dataset on which policy is based). This underscores the

importance attributed by both the government and the general public to the Fund's bi-annual Article IV consultation report. Needless to say, the authorities intend to publish the staff documentation.

Aruba remains one of the successful economies in the Caribbean with average growth of roughly 5 percent over the past decade and GDP per capita at roughly US\$22,000. However, partly due to the unfavorable external environment, growth decelerated quite sharply as of the second half of 2000, with growth in 2001 now expected at 1.5 percent GDP. Inflation remains subdued, reserves comfortable (at roughly 5-6 months of imports), public debt levels very low albeit increasing (22 percent, of which roughly half is external), and unemployment is virtually non-existent (despite a roughly 50 percent increase in the size of the population in the last 15 years). The exchange rate peg to the dollar has been unchanged since 1986 when the Aruban florin was first issued and, coupled with a healthy financial sector, this has produced a climate of stability conducive to private sector enterprise.

The authorities agree that there are fiscal issues that need to be tackled, including the need to curb entitlements, strengthen the tax administration, and further bolster the pension and health system. The new health system in particular is being closely monitored in its first full year of operation, as cost overruns are already putting pressure on the budget. This is contributing to a deterioration in the fiscal position and in 2001 a fiscal deficit of 2.5 percent GDP may be reached. Nevertheless, Aruba remains committed to achieving a balanced budget.

The Central Bank of Aruba (CBA) continues to successfully maintain the exchange rate peg with the dollar through an appropriately tight monetary stance. Staff rightly notes that, as a result, Aruba has "enviable financial stability." The CBA and the staff had extensive discussions on the possibility of moving to more indirect instruments of monetary policy. There is general agreement on the desirability of doing so, but there are sequencing issues not least due to the absence of a well-developed capital market. The authorities are in agreement with the road map sketched by the staff in the report and are considering the preparatory steps needed in this regard. They are also seeking assistance from the Netherlands to study if it is feasible to move away from the direct credit control system and the switch to more market-based instruments. As part of this overall strategy it is also being considered to raise the limits under which capital transactions can freely take place. This will be a cautious and gradual process, moving hand in hand with a further strengthening of prudential supervision.

The banking sector is considered sound with capital adequacy at over 10 percent. Foreign presence is high with five out of six commercial banks being associated with foreign banking groups. Aruba has only two offshore banks, both of which are U.S.-based (a branch and a subsidiary of Citibank)

and fall under the consolidated supervision of the U.S. authorities. An important development is that the central bank, aside from supervising all credit institutions and company pension funds, is now also responsible for supervising the insurance sector. The government is also considering to have the CBA take over the supervision of company service providers in order to strengthen supervision and subject these companies to greater transparency and a proper licensing system. It should be noted though that Aruba's offshore sector is quite small compared to other islands in the region. As the staff report notes, Aruba is in the process of completing the first phase of an offshore financial sector assessment.

Tourism remains the mainstay of the Aruban economy. Aruba is now the seventh largest tourism destination in the Caribbean with over 700,000 stay-over tourists (and another 500,000 cruise tourists), putting it just behind Jamaica and Puerto Rico, two much larger countries. Tourism arrivals increased by 5.5 percent in 2000 while hotel occupancy fell to 76 percent, due largely to the completion of the expansion of one large hotel. This is still among the highest occupancy rates in the region. The United States continues to be the most important market with roughly 64 percent of tourists. This is followed by Venezuela (16 percent), Colombia and the Netherlands (each roughly 4 percent). Particularly noteworthy was the 70 percent surge in the number of cruise ship passenger arrivals. More large ships included Aruba in their itinerary, partly because it lies outside the hurricane belt.

A positive recent development is that Aruba has been able to increase the number of flights from all major U.S. carriers to Aruba. This has partly allowed it to increase the number of U.S. tourists, while tourists from Europe and South America remain relatively constrained in their flying options. Air Aruba accounted for 50 percent of flights from South America. Following its bankruptcy, slack was picked up by other airlines but the number of flights to/from South America has still not been fully restored.

Thanks to the agreement reached with the OECD in May/June, Aruba has been removed from the list of jurisdictions with harmful tax practices. As regards anti-money laundering efforts, Aruba spearheads efforts in the region as the current chair of the Caribbean Financial Action Task Force. It also recently received a favorable assessment from the FATF when it was determined that it met 26 of 28 FATF recommendations requiring specific actions. This is only one less than the Netherlands and substantially more than most major industrial countries.

Mr. Portugal and Mr. Rambarran submitted the following statement:

At the outset, we thank the staff for a very cogent analysis of the economic situation and challenges facing the small, tourism-based island of Aruba as well as Mr. Wijnholds for his informative and helpful preliminary

statement. Aruba's economic performance over much of the past decade has been quite noteworthy relative to its Caribbean counterparts. Since 1995, real output has been growing at a sustainable average of nearly 4 percent, and inflation has been generally subdued with a narrow differential vis-à-vis the United States of under 1 percent. Close to full employment conditions prevail, with labor demand partly satisfied by large immigration flows. A broadly tight monetary policy has strengthened overall net foreign assets of the consolidated banking system to well within prudential margins. Weak fiscal discipline, however, has given rise to a widening budget deficit, financed mainly by the accumulation of payment arrears.

Economic growth is anticipated to moderate this year, largely reflecting a less certain global environment, which could soften tourism demand. In this context, the main challenges facing the authorities are to return the public finances to a more sustainable path and to deal with unresolved structural issues so as to minimize Aruba's vulnerability to external shocks and output volatility. We, therefore, broadly support their strategy based on fiscal consolidation, prudent monetary policy, and renewed efforts to allow private sector participation in telecommunications and tourism promotion.

We note the authorities' objective of achieving balanced budgets within the next two years. We welcome the study underway to identify cost-cutting measures that could counterbalance the high spending—just over 1 percent of GDP this year—of the newly introduced public health care system (AZV), and encourage the authorities to complement this effort with an assessment of the appropriate benefits, premium contribution rates, co-payments and deductibles necessary to guarantee the long-term financial viability of the AZV. Expenditure control must also address the growth of the public sector wage bill, which accounts for 60 percent of tax revenue. In light of Aruba's low tax revenue-to-GDP ratio, especially when compared to other Caribbean countries, we welcome plans to reform the tax system and tax administration, including consideration of the possible introduction of a VAT. Reforming budgetary procedures, clearing existing obligations, and avoiding the future accumulation of arrears would also be important steps in fostering good fiscal governance.

We look forward to the authorities extending the actuarial study on budgetary obligations beyond the civil servants' pension fund (APFA) to include the universal old age pension system (AOV).

Monetary policy has skillfully maintained the credibility of the long standing fixed exchange rate of the Aruban florin with the U.S. dollar, relying primarily on credit ceilings to ensure an adequate level of net foreign assets. While these direct instruments are not appropriate in the Aruban context, especially given the openness of the economy, the current scope for

employing open market operations seems rather limited in light of the smallness of the domestic money and capital markets and the oligopolistic structure of the banking system. We, therefore, would advocate a cautious approach in moving towards indirect monetary management. Staff comments would be appreciated.

Since 1998, Aruba has made considerable progress in strengthening the regulation and supervision of its onshore and offshore financial institutions, as well as in preventing crime-related financial activities, for which the authorities should be commended. We welcome in particular the recent legislation to formalize supervision of the insurance sector and the ongoing review, with MAE assistance, of the regulation and supervision of the offshore sector. Furthermore, the authorities have embarked on a self-assessment under the OFC program, with Fund technical assistance. We look forward to the authorities sustaining this pace of reform by passing pending legislation and allocating sufficient resources to its implementation.

Looking ahead and in the context of a hard exchange rate commitment, we would place special emphasis on a properly functioning labor market with sufficient wage flexibility to help the Aruban economy to cope with shocks. Competitive advantage in key service sectors—offshore finance and upscale tourism—has to be derived from high labor productivity. We would also stress the need to advance the pace of privatization in order to boost private investment and improve overall competitiveness.

Given the importance of timely and reliable data to effective surveillance and policy formulation, we encourage the authorities to improve the coverage and quality of Aruba's statistical base, particularly in the areas of national and public sector accounts and labor markets.

In conclusion, we wish the authorities every success in their endeavors ahead.

Mr. Kwakye made the following statement:

Maintaining an exchange rate peg underpinned by monetary and financial stability has enabled Aruba to sustain low inflation, growth, and investor confidence. While the authorities are to be commended for this achievement, its sustainability will require addressing the economy's vulnerability to external shocks and budget management weakness, as well as implementing much needed structural reforms. We agree with the thrust of the staff appraisal and make a few points stressing the need for strong fiscal policies and accelerated structural reforms, among other policy initiatives.

A strong fiscal stance is key to ensuring a sustained supply of public Fund's bi-annual Article IV consultation report. Needless to say, the authorities intend to publish the staff documentation. savings to bolster private sector activity, calling for a reversal of the deteriorating fiscal position. Achieving fiscal surplus should also help to reduce external borrowing and sustain market confidence. In light of this, it is of some concern that the budget deficit for 2001 is projected to increase, particularly as it arises from increased current expenditure and reduced revenue. The poor revenue performance is due in part to persistent weaknesses in the tax system, as amplified by over reliance on less buoyant direct taxes, excise taxes, and import duties. In these circumstances, rather than raising the average import tariff, whose current unweighted level already ranks high internationally, and which will increase input costs for business and erode competitiveness, serious consideration should be given to an early introduction of a VAT. The plan to reform tax administration is however most welcome.

On the expenditure side, there is scope for curtailing the high recurrent spending, while protecting essential social programs. To this end, the public sector wage bill should be restrained by limiting hiring and any increases in remuneration. Substantial savings can also be made on the recurrent budget by streamlining the health care system to increase efficiency and achieve cost effectiveness, while targeting subsidized service to the needy.

Furthermore, a reform of the pension system is necessary to reduce administrative costs as well as ensuring its long-term solvency. Public expenditure management as a whole needs to be improved, including through strengthening the administrative procedures and improved accounting, transparency, and monitoring from the appropriations stage to final spending. While the accumulation of domestic arrears in 2000 after the progress made to clear them in 1999 is viewed as a temporary setback, further build up should be avoided while setting a definite timetable to roll back existing arrears.

Maintaining a tight monetary policy stance, cushioned by foreign exchange reserves, has assured stability of the exchange rate peg and low inflation. There is, however, a need for more flexibility in the monetary policy framework, not only to strengthen liquidity management, but also to service an active complement to fiscal policy.

Market-based instruments should be promoted, together with financial liberalization to engender competition and efficiency in the financial system. To reduce the risk of crisis following financial liberalization, a well-regulated and robust financial system is needed. Efforts to strengthen the deregulation and supervision of onshore and offshore financial sectors, as well as measures to check money laundering and related financial crimes are important steps in this direction. An accelerated pace of structural reforms is key to improving

efficiency, attracting investment, and harnessing the country's growth potential. Given the volatility of economic activity due to the lack of diversification and vulnerability to external shocks, the staff is right in perceiving a downside risk to growth in 2001 as a consequence of the expected weak external demand for tourism services.

Although some recovery in domestic output is expected in 2002, the long-term sustainability of growth cannot be guaranteed without strong policy intervention. Diversifying the economy should enhance long-term growth prospects. To this end, privatization initiatives should be given added momentum. In particular, privatization of tourism and telecommunications services should be accelerated to inject capital and efficiency into these major sectors of the economy.

Finally, while progress on the publication of money, banking, and balance of payments data is welcome, the lack of progress on updating the national accounts, which has published data only up to 1994, and public finance statistics among others, gives cause for concern. To ensure effective surveillance as well as meaningful analysis and planning, the authorities are encouraged to use available technical assistance to improve the coverage and timeliness of economic and social statistics.

Ms. Davidson made the following statement:

At the outset, I would like to highlight the introductory comments in Mr. Wijnholds's statement. Mr. Wijnholds notes that Aruba is an example of an economy where Fund surveillance has had a significant impact. The same can be said for many members of our constituency. It is the smaller members of the Fund who can benefit most from the Fund's surveillance and policy advice, along with documentation and data support.

As the staff notes, performance of the economy has indeed been impressive. Prudent monetary policy management and the authorities' efforts in strengthening the supervisory and regulatory arrangements for the financial sector, including anti-money laundering efforts and regulation of offshore financial activities deserve commendation. We hope ongoing strengthening of financial sector supervision provide the basis for increased long-term investment. The authorities are not intending to rest on their laurels in terms of effective monetary policy management with plans to introduce greater flexibility into the framework with further financial sector and capital account liberalization.

Against the background of good performance in 2001, it is disappointing that the deterioration in the fiscal position, including the accumulation of payment arrears, casts a shadow. This is especially the case given efforts aimed at consolidation in 1998/99 which seemed to have fallen

by the way side. It is encouraging that the authorities recognize that problems in this area need to be addressed, and have as their objective the elimination of the budget deficit. There were calls from the Board for improved fiscal management at the time of the last Article IV consultation, but it seems the authorities now face a bigger task in reducing the deficit. We encourage the authorities to invigorate plans to eliminate budget deficits in the medium term and agree there is a need to improve the budgetary process.

We are particularly concerned about the pressure on the budget from the public health system. It seems the authorities' commitment to a balanced budget is likely to wane unless action is taken to curb expenditure on the health sector. The staff identified areas where changes could be made to restrain the cost and assist in ensuring the sustainability of the system in the medium term. Targeted health coverage rather than an open-ended system would be desirable. Co-payments should be introduced, along with deductibility and premium contribution rates for particular segments of the population. The staff notes that the authorities were considering some immediate cost-cutting measures, but of a limited scope. We would appreciate further detail from the staff on the measures being considered by the authorities, and also the authorities' reaction to the options that have been suggested by the staff. We note that the authorities are probably in a difficult political position in having to make changes to the system so soon after its introduction. But it is important to recognize that the longer the system remains as it is, the harder it will be to make changes later.

There is also a need to reduce the public sector wage bill, which has contributed to fiscal slippages in the past. In this area, the staff recommends including policies to bring public employment down over the medium term, and we would appreciate staff comments on what could be envisaged. For example, are there any plans to undertake efficiency reviews?

We agree with the policy priority accorded to comprehensive tax reform. We encourage the authorities to keep an open mind in respect to the introduction of a consumption tax as they further develop their tax reform plans. We recognize that structural reforms are often difficult given political realities, but it is important that progress is made in this area. Like the staff, we believe that structural reforms should be an important pillar of policy to assist in attracting investment and expertise, and also to reduce budgetary costs. An important step in this regard would be to progress with reform of the telecommunications operator. We would be interested in any indication from the staff as to whether there are any concrete strategies such as timetables in place for the privatization of enterprises other than CETA. For example, are there concrete plans in place for the sale of the Radisson hotel? We have read reports that there has been some frustration on the part of private sector bodies with the lack of progress on the privatization of the Aruba Tourism Authority. This frustration and the potential consequences for investment is of concern

given the importance of tourism to the economy. The staff recommends private sector participation in management and independence from political influences for the tourism authority. I would be interested to hear if there are other enterprises that the staff consider as priorities in terms of benefiting from corporatization or private sector management, perhaps as an interim step to privatization. In closing, we again commend the authorities for their achievements and wish them well as they address the remaining challenges.

Mr. Walsh made the following statement:

On fiscal policy, like the staff, I urge the authorities to analyze the current fiscal arrangements. The authorities should work over both the short and medium term to reform both revenue and expenditure measures and to improve transparency and operational efficiency of the tax system. As Box 1 in the report makes clear, the excessive use of tax exemptions, tax holidays and various tax brackets has created an overly complicated tax system for what is a relatively small economy. Exemptions have served to undermine the government's revenue base contributing in part to the current fiscal weakness.

Going forward, it is important for the authorities to address the structural weaknesses quickly to ensure the tremendous economic success that Aruba has enjoyed since moving to autonomous status within the Kingdom of the Netherlands. On the expenditure side, the staff are right to emphasize the need to tackle arrears, the pension system, and reform of the new public health care system. The latter in particular would appear to have the possibility of becoming an enormous drain if left unchecked. Suitable action to tackle incentives, waste, and abuse need to be put in place quickly if the health system is not to undermine Aruba's fiscal stability.

Turning to Aruba's offshore financial sector, I am encouraged by the authorities' recent action in this area. It would appear that supervision and regulation of Aruba's relatively small offshore financial sector has been improved significantly over the last year. By working closely with international bodies, neighboring financial jurisdictions, and the staff under the ongoing module 1, OFC assessment, the authorities have come to bring their financial sector into line with international best practices. I hope that these efforts are maintained in the coming months and years, allowing the necessary legislative changes to be introduced to support the regulatory amendments, and that these are followed up by full and effective implementation of the new powers, an issue on which the next Article IV report should comment.

On the quality of statistics, it appears that Aruba's statistical base is far weaker than many similar sized economies even within the region. Improvements are welcome and the increase in resources devoted to statistics collection are a step in the right direction. Looking ahead, the lack of good

quality public sector and budgetary data at a time when the fiscal system is increasingly coming under strain would appear to require urgent attention. In future reports, I would find it helpful if the staff could provide more information on Aruba's data provision relative to similar economies. This kind of benchmarking exercise within the region could prove very useful going forward. For now, I would appreciate it if the staff could comment on both the absolute and relative quality or weakness of Aruba's statistical base. Do the authorities have sufficient data available to allow them to monitor economic developments?

Mr. Whitehall made the following statement:

We want to commend the authorities in Aruba for their economic performance through strength of the real sector, low inflation, and an appropriate monetary policy underpinned by a fixed exchange rate. We are also encouraged by the efforts to strengthen the regulatory and supervisory framework of the financial sector. Nonetheless, we have noted the rapid increase in population. Aruba's population density now exceeds most of the region apart from Barbados. Another source of concern is the weak economic outlook which is expected to slow the performance of the tourism sector. However, from our point of view, the main challenge is to accelerate the pace of public sector reform while laying the groundwork for diversification. Staff comments would be welcome on the prospects for diversification in Aruba.

We encourage the authorities to build on past successes, and to strengthen the framework of generally good economic policies. Fiscal weakness in the short term is to be expected, given the plans for the health and social security system, together with the increase in immigration in recent years. We also note that the wage bill is high as a proportion of tax revenue relative to economies in the region. Combined with low tax buoyancy, this suggests that consideration of a VAT could prove worthwhile. We are also concerned about the provision of tax exemptions and support the comments of Mr. Walsh that transparency should be increased when it comes to the system of tax exemptions.

Finally, the statistical base appears weak, even when compared with similar economies in the Caribbean, and we encourage the authorities to avail themselves of the necessary technical assistance so that the statistical base can be strengthened. We agree with the comments of other chairs also on the need to accelerate privatization in areas where this seems to be viable in the context of Aruba. With these remarks, we encourage the authorities as they proceed with their reform program.

Mr. Abel made the following statement:

Even though the available data on Aruba is sparse, the staff have managed to support their policy arguments. My own country, Hungary, with its population of 10 million, is considered like Canada to be a small, open economy. As such, both Hungary and Canada seek affinity with a large economic grouping by gradually giving up a measure of their policy discretion. In contrast, the Aruban authorities seem to be trying to reach the goal of prosperity by another route, and if they heed the recommendations of the staff, they might well be able to do so. Since I have no doubt about the Aruban authorities' ambition or the staff's recommendations, I can confine myself to seeding clarification on three points. My questions:

First, since the capital account is fairly liberalized and the exchange rate fixed, what protection does Aruba have from external shocks? Capital flows already display some volatility with a FDI to GDP ratio of 22 percent in 1999, dropping to negative 12 percent in 2000.

Second, does Aruba's pursuit of an independent monetary policy and maintenance of its own currency result in seigniorage income or seigniorage costs?

Third, in Hungary's case, for example, fiscal discipline is supported by the desire to become a member of the European Union. In Aruba's case, what factors are strong enough to withstand the political pressures that threaten the country's fiscal sustainability?

Mr. Vogel made the following statement:

We agree with the staff on the desirability of fostering greater diversification of the economy, while consolidating Aruba's position in its main sector, tourism. As Mr. Wijnholds notes in his helpful statement, the fixed exchange rate regime has produced a climate of stability conducive to private sector enterprise. However, given the openness and small size of the Aruban economy and its vulnerability to external shock, it will be necessary to accelerate the fiscal and financial sector reforms.

The limited room for maneuver of monetary policy places the burden of adjustment on fiscal tightening and acceleration of structural reforms. In this regard, the deteriorating trend in the public finances leading to recurrent budgetary liquidity, shortages, and an accumulation of arrears merits the consideration of the authorities. To underpin the long-term sustainability of the public finances, reform of the tax system emerges as a priority.

As shown in Box 1 of the staff report, the structure of taxes presents multiple exemptions for personal income tax and special treatment by the administration of the corporate tax system, while import duties are

differentiated. Having said this, we agree with the staff that the measures that the authorities plan to implement are well-founded and aim at simplifying the tax system.

The public health care system and the pension system warrant further adaptation. Given the cost overruns and abuse since implementation of the recent reform, we urge the authorities to consider rebalancing the contribution to and benefits from the health system. On the pension system, we note the authorities' initiative to rationalize the current level of transfers as an important step. Long-term solvency of the system is a concern, and the envisaged redefinition of the retirement age and the level of pensions should be supplemented by a cost and benefit analysis of the capitalization system.

Turning to other structural issues, we welcome the significant efforts of the authorities to strengthen the supervisory and regulatory framework of offshore financial activities. We urge the authorities to improve the statistical data given its high degree of uncertainty. With these remarks, we wish the authorities every success in their future endeavors.

The staff representative from the Western Hemisphere Department (Mr. Escolano), in response to questions and comments from Directors, made the following statement:

On issues relating to monetary policy, the scope for maneuver is narrow, and as recommended by the staff in discussions with the authorities, their approach should be cautious. Monetary policy should only be used to initiate moves on interest rates (which are relatively sticky at present) to smooth unwarranted fluctuation of liquidity, but not to achieve any predetermined level of liquidity, inflation, or interest rates. The authorities are aware of this limitation, and also see a role in the use of these instruments to deepen the financial markets, though progress will be cautious and gradual. The authorities intend to request technical assistance on these matters from either the Central Bank of the Netherlands or the IMF.

On the question about seignorage, it amounted to 0.6 percent of GDP per annum in 2000. In net terms, after deducting the cost of running the central bank itself, it amounted to 0.4 percent. It is small, but cannot be dismissed.

On fiscal policy, measures planned and implemented by the authorities to lower the cost of the AZV system were limited in scope and implemented through administrative measures. They did not include any substantive restructuring of entitlements or revenue. For example, prescriptions that were customarily extended by three or six months were reduced to one month. This kind of measure does contain costs, but is short of what would be needed to make the system viable. The authorities were interested in the staff's suggestions, particularly the ministry of finance. Members of the cabinet were

less interested, at least for immediate implementation. In particular, the ministry of health was not that interested in considering measures such as the introductions of copayments or an increase in deductibles for this year. Radical changes cannot be expected in 2001, but perhaps in 2002.

Regarding measures to cut public sector employment, in the past, there was consideration of individual performance evaluations of government employees. There was a plan for early retirement which offered some incentives. But, again, this year, these initiatives were suspended, or at least there has been no progress in this area. Again, there is the possibility that it will be reconsidered next year.

Regarding structural policies, Air Aruba, the national airline, has been closed by the ministry of finance after partial privatization in 2000. There are plans to sell the government's stake in the Radisson Hotel later this year, and the revenue is already counted in the budget. Privatization of the tourism authority is opposed by a small partner in the present coalition government. Nonetheless, the opposition is in favor of privatization, and progress in this area can be expected soon after the election in September 2001. It has also been suggested that the postal service should be privatized to foster its independence from political interference. Presently, it has status as a part of a ministry in the civil service, and could be considered for incorporation.

The staff agrees that data quality is below the standards of other countries in the region. As Directors mention, this impairs the capability of the authorities to make informed decisions. The private sector would also benefit from improvement in the statistics.

Last, it should be noted that although it is true that foreign direct investment is volatile, it includes the balance of payments related to the oil sector, which is basically the operations of one company that processes oil for export. The non-oil balance of payments is more pertinent to the domestic economy and is much less volatile.

Mr. Wijnholds made the following concluding statement:

It is always useful to have Board remarks presented to the authorities. A small place like Aruba is always interested in what the Fund has to say. The economy and the administration in Aruba are well run compared to the neighboring Netherlands Antilles. Nonetheless, it is rightly said that there are some problems which the government needs to face. The government recently fell and there will be elections on September 28th. The focus of today's discussion of improving the fiscal position will serve as a strong message to any new government.

On monetary policy, there is a sound tradition that the central bank governor comes from either the IMF, the U.K., or the Bank of England. Although it is true that Aruba is a heavily populated island, from the regional perspective, this a good phenomenon, and the population density in Aruba is the same as in the Netherlands.

On diversification, this is always a problem for such a small place, and there is not much scope beyond what exists at present. Although it makes Aruba somewhat vulnerable, a lack of diversification is in some instances desirable. At some point there was an idea of starting a car racetrack on the island, which would have been environmentally disastrous. The previous central bank governor was involved in stopping the project, and it has been stopped. In the area of tourism, many more cruise ships have been coming to Aruba, partly because it is not in the hurricane belt. Islands such as St. Maartin, which is partly Dutch, have suffered tremendously from hurricanes.

Finally, on seignorage, it does exist. There are florins which not many of the tourists ever see. At a recent lunch with the central bank governor, he showed me many of these nice looking notes and made sure to pay in florins and not in dollars. We will look forward to discussing Aruba in two years' time.

The Acting Chairman made the following summing up:

Executive Directors agreed with the thrust of the staff appraisal. They commended the authorities for the positive performance of the Aruban economy over the past decade. Directors noted that the economy's sustained expansion had been underpinned by growth-oriented economic policies and accompanied by low inflation and financial stability.

Looking ahead, Directors agreed that the challenge now was to diversify economic activity while consolidating Aruba's position in the tourism market, so as to minimize vulnerability to external shocks and output volatility. Directors emphasized that success in this direction would hinge on policies that strengthen financial stability and attract domestic and foreign savings. These policies should be geared to increasing the public sector's contribution to national savings; reinforcing financial safeguards and the monetary policy framework, coupled with a sequenced liberalization of remaining credit and capital restrictions; and improving transparency and promoting entrepreneurship.

Directors agreed that the authorities' objective of eliminating the budget deficit was appropriate and should be complemented by a modest surplus over the medium term. Directors expressed concern at the deterioration of the budgetary position and urged the authorities to address

existing fiscal imbalances without delay. They stressed that it was essential to contain current spending, notably on payroll costs, and restore budgetary discipline, particularly by eliminating payment arrears. Directors also encouraged the authorities to limit the strain on the budget from the public health system by tightening entitlements, introducing co-payments and deductibles, and increasing contribution rates, if necessary. They welcomed the ongoing review of the public employees' pension fund (APFA) and called for a revision of pension entitlements with a view to ensuring the pension system's financial viability.

Directors encouraged the authorities to strengthen budgetary management procedures, and supported the authorities' intentions to reform the tax system and its administration. Directors agreed with the authorities' objectives to simplify the tax system, curtail special tax treatments, and increase reliance on indirect taxes. They suggested that the authorities consider introducing a broad-based consumption tax.

Directors commended the authorities for their prudent management of monetary policy as demonstrated by the credibility of the peg of the Aruban florin to the U.S. dollar, supported by a strong reserves position. Directors considered that the tight monetary policy stance adopted by the Central Bank of Aruba in early 2000 was appropriate and should be maintained until demand pressures abate—a development that was already under way. They endorsed the authorities' efforts to introduce flexibility in the monetary policy framework, and further liberalize external capital transactions. Directors considered that the gradual elimination of remaining credit and capital balance restrictions should be implemented in parallel with measures to strengthen the liquidity and prudential requirements on the banking system, and with reinforced supervision.

Directors observed that Aruba had made substantial progress in strengthening the regulatory and supervisory framework for onshore and offshore financial activities, including in the area of fighting crime related to international financial transactions. They also welcomed the agreement reached with the OECD on harmful tax practices. The authorities were encouraged to sustain the pace of reforms in the supervisory area through prompt passage of the necessary legislation regarding the regulation of company service providers in the offshore sector.

Directors encouraged the authorities to advance the pace of privatization, particularly in telecommunications, in order to boost private investment and improve productivity and competitiveness. Plans to grant operational autonomy to the Aruban Tourism Agency (ATA) and include the private sector in its management were welcomed.

Directors urged the authorities to intensify their efforts to improve the statistical base, and noted that progress in this area was essential to increase transparency, facilitate economic decision making, and allow effective surveillance. In particular, Directors emphasized the importance of providing timely budgetary data, economic activity and labor market indicators, and national accounts in accordance with standard international methodologies.

It is expected that the next Article IV consultation discussions with Aruba will be held on a 24-month cycle.

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/01/83 (8/3/01) and EBM/01/84 (8/22/01).

4. BULGARIA—REPRESENTATIVE RATE FOR BULGARIAN LEV

1. The Fund determines, after consultation with the authorities of Bulgaria, that the representative exchange rate under Rule O-2, paragraph (b)(ii) of the Fund's rules and regulations for Bulgarian currency against the U.S. dollar is 1/1.95583 of the reference rate for the euro in terms of the U.S. dollar as published by the European Central Bank on a daily basis at 2:15 p.m. Central European Time (CET).

2. The Bulgarian National Bank will inform the Fund of any changes affecting the definition of the representative rate. (EBD/01/65, 8/10/01)

Decision No. 12549-(01/84), adopted
August 17, 2001

5. ERITREA, NEPAL, SAUDI ARABIA, TANZANIA, AND UNITED ARAB EMIRATES—ARTICLE IV CONSULTATIONS—POSTPONEMENT

Notwithstanding the period of three months specified in Procedure II of the document entitled "Surveillance Over Exchange Rate Policies," attached to Decision No. 5392-(77/63), adopted April 29, 1977, as amended, the Executive Board decides that the period for completing the next Article IV consultation with Nepal, Eritrea, United Arab Emirates, Tanzania, and Saudi Arabia shall be until the dates indicated in EBD/01/67 (8/14/01) for such countries.

Decision No. 12550-(01/84), adopted
August 17, 2001

6. MALI—ENHANCED INITIATIVE FOR HEAVILY INDEBTED POOR COUNTRIES—ADDITIONAL INTERIM ASSISTANCE

The Fund as Trustee (the “Trustee”) of the Trust for Special PRGF Operations for the Heavily Indebted Poor Countries and Interim PRGF Subsidy Operations (the “Trust”) decides:

(a) that satisfactory assurances regarding the exceptional assistance to be provided under the enhanced HIPC Initiative by Mali’s other creditors continue to be in place, and

(b) that the Trustee shall disburse to Mali as additional interim assistance the equivalent of SDR 5.746 million, which shall be made available by the Trustee to Mali in the form of a grant that shall be paid no later than three business days after the adoption of this decision to the account for the benefit of Mali established and administered by the Trustee in accordance with Section III, paragraph 5 of the Trust Instrument; the proceeds of the grant shall be used by the Trustee to meet Mali’s debt service payments on its existing debt to the Fund as they fall due, in accordance with the following schedule: 37.3 percent of each repayment obligation falling due between September 1, 2001 and December 31, 2001, and 24.0 percent of each repayment obligation falling due between January 1, 2002 and August 31, 2002. (EBS/01/131, Rev. 1, 8/9/01)

Decision No. 12551-(01/84), adopted
August 16, 2001

7. MALI—ORIGINAL INITIATIVE FOR HEAVILY INDEBTED POOR COUNTRIES—CORRECTION TO TABLE IN COMPLETION POINT DECISION

1. The Fund, as Trustee (the “Trustee”) of the Trust for Special PRGF Operations for the Heavily Indebted Poor Countries and Interim PRGF Subsidy Operations established by Decision No. 11436-(97/10), adopted February 4, 1997, notes the report of the staff set forth in paragraph 4 of EBS/01/131, Rev. 1 on the correction to the table on the “Delivery of IMF Assistance under the Original HIPC Initiative” referenced in paragraph 2 of the HIPC completion point decision for Mali (EBS/00/163, Sup. 2), adopted September 8, 2000.

2. Accordingly, the Trustee decides to replace the table referenced in paragraph 2 of the HIPC completion point decision for Mali with the table attached hereto. (EBS/01/131, Rev. 1, 8/9/01)

Decision No. 12552-(01/84), adopted
August 16, 2001

8. 2001 ANNUAL MEETING—FORMAL NOTICE AND BRIEF AGENDA

The Executive Board approves the draft formal notice and brief agenda for the 2001 Annual Meeting. (EBD/01/69, 8/17/01)

Adopted August 17, 2001

9. 2001 ANNUAL MEETINGS—TIMING

The Executive Board considers that, due to special circumstances, the Plenary Session for the 2001 Annual Meetings of the Board of Governors of the Fund and the Bank be held on Sunday, September 30, 2001, instead of October 2-3, 2001. (EBD/01/66, 8/10/01)

Adopted August 14, 2001

10. ANNUAL REPORT, 2001—TRANSMITTAL TO BOARD OF GOVERNORS

The Executive Board approves the transmittal of the 2001 Annual Report to the Board of Governors under cover of the letter set forth in EBD/01/68 (8/15/01).

Adopted August 21, 2001

11. JOINT COMMITTEE ON REMUNERATION OF EXECUTIVE DIRECTORS—GOVERNORS' VOTE

The Executive Board approves the report of the Secretary (EBAM/01/77, Sup. 2, 8/16/01) on the canvass of votes of the Governors on Resolution No. 54-4, with respect to the remuneration of Executive Directors and their Alternates, approved by the Executive Board (EBM/01/71, 7/11/01) for submission to the Board of Governors. The Governors' vote on the Resolution is recorded as follows:

Total affirmative votes	1,117,727
Total negative votes	763,503
Total votes cast	1,881,230
Abstentions recorded ¹	226,035
Other replies	0
Total replies	2,128,815
Votes of members that did not reply ²	<u>59,474</u>
Total votes of members ³	2,166,739

(EBAM/01/77, Sup. 2, 8/16/01)

Decision No. 12553-(01/84), adopted
August 16, 2001

¹ Argentina, Belgium, Germany, Latvia, Mexico, Solomon Islands.

² Angola, Bosnia and Herzegovina, Comoros, Republic of Congo, Côte d'Ivoire, Ecuador, Equatorial Guinea, Guinea, Guyana, Mauritania, Niger, Papua New Guinea, Tajikistan, Vanuatu. Communications from Chad, Lao People's Democratic Republic, Socialist People's Libyan Arab Jamahiriya, Mozambique, Sudan and Zambia could not be counted for technical reasons. Affirmative communications from Algeria and Georgia were received too late to be counted. The Secretary's communications were not sent to Islamic State of Afghanistan and Somalia.

³ The Democratic Republic of the Congo's voting rights were suspended effective June 2, 1994, pursuant to Article XXVI, Section 2(b) of the Articles of Agreement; therefore, the total votes of members excludes the votes previously exercised by the Democratic Republic of the Congo.

**12. EXECUTIVE BOARD COMMITTEES AND EVALUATION GROUP—
NOMINATIONS**

The Executive Board approves the proposal by the Managing Director for renewals in membership and changes in committee assignment as set forth in EBD/01/64 (8/10/01).

Adopted August 21, 2001

13. APPROVAL OF MINUTES

The minutes of Executive Board Meetings 99/35, 99/108, 00/12, 00/29, 00/32, 00/33, 00/36, 00/74, 00/78, 00/80, 00/83, 00/95, 00/96, 00/98, 00/104, 00/107, 00/126, 00/127, 00/128, 00/129, 01/19, 01/20, 01/22, 01/24, 01/25, and 01/40 are approved.

14. EXECUTIVE BOARD TRAVEL

Travel by Executive Directors, as set forth in EBAM/01/87 (8/3/01), EBAM/01/89 (8/14/01), and EBAM/01/93 (8/20/01); by Advisors to Executive Directors, as set forth in EBAM/01/89 (8/14/01) and EBAM/01/93 (8/20/01); and by Assistants to Executive Directors, as set forth in EBAM/01/88 (8/8/01) is approved.

15. TRAVEL BY MANAGING DIRECTOR

Travel by the Managing Director as set forth in EBAP/01/80 (8/3/01) is approved.

APPROVAL: November 2, 2001

SHAIENDRA J. ANJARIA
Secretary