

## INTERNATIONAL MONETARY FUND

## Minutes of Executive Board Meeting 85/189

10:00 a.m., December 30, 1985

R. D. Erb, Acting Chairman

Executive Directors

A. Alfidja

B. de Maulde

H. Fujino

J. E. Ismael

F. L. Nebbia

Y. A. Nimatallah

P. Pérez

J. J. Polak

A. K. Sengupta

S. Zecchini

Alternate Executive Directors

Mwakani Samba

M. K. Bush

E. L. Walker, Temporary

L. Hubloue, Temporary

S. de Forges

T. Alhaimus

B. Goos

Jiang H.

H. A. Arias

M. Foot

H. Fugmann

J. W. K. Pickering, Temporary

A. Abdallah

J. E. Suraisry

A. V. Romuáldez

O. Kabbaj

A. Vasudevan, Temporary

N. Coumbis

A. Wright, Acting Secretary

S. J. Fennell, Assistant

Also Present

Legal Department: F. P. Gianviti, Director Designate; J. G. Evans, Jr., Deputy General Counsel; Ph. Lachman. Treasurer's Department: T. Leddy, Deputy Treasurer; D. Berthet, J. E. Blalock, B. Von Numers, G. Wittich. Personal Assistant to the Managing Director: R. M. G. Brown. Advisors to Executive Directors: P. E. Archibong, M. B. Chatah, S. Ganjarerndee, S. M. Hassan, J. Hospedales, J.-C. Obame. Assistants to Executive Directors: H. Alaoui-Abdallaoui, A. Bertuch-Samuels, J. de la Herrán, S. Geadah, V. Govindarajan, Z. b. Ismail, S. King, K. Murakami, A. Mustafa, J. Reddy, C. A. Salinas, L. Tornetta, A. J. Tregilgas, H. van der Burg.

1. OVERDUE FINANCIAL OBLIGATIONS - SPECIAL CHARGES

The Executive Directors considered a staff paper on further considerations relating to special charges to recover costs and losses arising from members' overdue financial obligations to the Fund (EBS/85/242, Sup. 1, Cor. 2, 12/17/85). The paper also contained a draft decision reflecting Executive Directors' agreement in principle at EBM/85/175 and EBM/85/176 (12/6/85) to establish a system of special charges based on Option A in EBS/85/242 (10/29/85) with the modification that special charges for Trust Fund obligations would be based on a level midway between the SDR interest rate and the rate of interest on Trust Fund loans.

Mr. de Maulde, Mr. Fujino, Mr. Ismael, Mr. Nimatallah, Mr. Foot, Mr. Fugmann, Mr. Goos, and Mr. Romuáldez indicated their agreement with the proposed decision.

Mr. Zecchini stated that he favored the introduction of a system of special charges that would impose some of the costs of overdue obligations on the countries in arrears to the Fund and would provide further incentives for members to repay the Fund. At the previous discussion on the issue, his chair had been in favor of Option B, which was simpler, as it allowed for the imposition of a flat rate on all overdue obligations. Furthermore, it applied special charges to all sources of financing, including borrowed resources. The credibility of the Fund was at stake also in the case of nonpayment of borrowed resources, and that represented a cost for the Fund which justified special charges on those obligations. Moreover, Option B represented a good solution with respect to charges on Trust Fund obligations because it imposed a rate of charge that represented a compromise between the application of the market rate and no special charge, as proposed by some members.

Although he still favored Option B, he was willing to be flexible in order to reach a necessary consensus in the Executive Board to implement a system of special charges by supporting the proposal based on Option A, Mr. Zecchini indicated. However, he had two suggestions. First, with respect to the General Resources Account, special charges would be applied only to overdue interest payments. As the rate of charge presently exceeded the SDR interest rate, no special charges would be imposed on overdue repurchases. There was likely to be a paradoxical situation that because of the very costs connected with overdue payments, special charges on overdue purchases would currently be equal to zero. Special charges should be imposed on overdue repurchases as well as on overdue interest payments in order to encourage more prompt repayment. For example, a provision could be introduced under which special charges would be equal to the higher of two rates: the difference between the SDR interest rate and the rate of charge in effect, and a predetermined interest rate that would be equal to 1 percent or 2 percent. Second, special charges on overdue interest payments should be the higher of the SDR interest rate and the rate of charge. Based on Section II of the proposed decision,

the rate paid on overdue interest payments--the SDR rate of interest--would be lower in present circumstances than the interest rate paid by debtor members that were current with the Fund--7.87 percent.

Mr. Polak stated that he agreed with the thrust of the proposed decision but had questions about its form. He wondered whether it was advisable to have a single decision for overdue obligations to the General Resources Account and to the Trust Fund. As the decision would be reviewed in the near future, it seemed unnecessary to include a long provision on overdue repurchases, which had no operational significance. As the rate of charge was unlikely to be below the SDR interest rate in the near future, the Fund would not be levying any additional small charge on overdue repurchases. It might be better to simplify the decision.

The Deputy Treasurer stated that the proposal in the staff paper was consistent with the concept of cost recovery in a narrow financial sense. Earlier staff papers and Board discussions had considered the measure of cost and concluded that the SDR rate of interest was a reasonable standard for the measurement of cost to the Fund in that narrow sense, although there were broader kinds of costs of a nonfinancial nature associated with overdue obligations. Mr. Zecchini's proposal went beyond the objective of covering the direct financial cost to the Fund of overdue obligations and would introduce an overt incentive for members to become current with the Fund.

The Deputy General Counsel remarked that the Executive Board, by a 70 percent majority, could set whatever charge it wished on overdue repurchases in accordance with Article V, Section 8(c); the other special charges were based on the recovery of damages to the Fund occasioned by the nonpayment of periodic charges.

Mr. Vasudevan remarked that Mr. Zecchini's proposal would introduce a considerable degree of flexibility in the sense that there would be no one underlying principle governing the rate of special charge. His proposal was perhaps going beyond the concept of cost recovery, as laid down in the staff paper.

The Deputy Treasurer commented that such a system would also introduce other considerations and objectives, although it would not introduce greater flexibility in the sense that the system would be administered according to specified formulas based on the Board's decision.

Mr. Abdallah stated that his authorities remained unconvinced that special charges on overdue Trust Fund obligations would enable the Fund to recover the financial losses incurred as a result of those late repurchases. Rather, the imposition of such charges would complicate debtor members' financial problems and render the conclusion of an agreement with the Fund even more difficult. The only way to ensure timely repayment to the Fund was to restore financial stability and ensure the resumption of

economic growth in the debtor countries. The Fund should intensify positive action in that direction--the only real viable solution to the problem of overdue financial obligations. Finally, his chair continued to oppose the proposed decision.

Mrs. Walker stated that she was in general agreement with the proposed decision. The staff, in its paper on the use of resources of the Special Disbursement Account (EBS/85/283) to be discussed by the Board in late January, underscored the fact that the cost of overdue Trust Fund obligations could go beyond the costs that would be recovered by the rate of special charge on those obligations based on the formula proposed in the decision before the Board. While that issue should be focused on by the future prospective recipients of resources from the Special Disbursement Account, it was worth noting the impact that overdue Trust Fund obligations could have on the planning of commitments and the initiation of disbursements from that account. On December 2, 1985, overdue Trust Fund obligations had amounted to more than SDR 42 million. Disbursements from the Special Disbursement Account under the new facility to be established would be constrained by the amounts actually available in that account. Uncertainties regarding inflows, particularly the possibility of overdue obligations, suggested caution in the commitment of new funds. Furthermore, the staff had indicated in its paper that commitments for disbursements from the Special Disbursement Account would be subject to the availability of funds in light of the possibility of delays in members repaying their Trust Fund obligations. While she understood some members' desire to make the rate of special charge on overdue obligations to the Trust Fund reflect the concessionary nature of those resources and could go along with the proposed formula, it was worth considering, before the Board's discussion in January on the use of the resources in the Special Disbursement Account, the potential cost of overdue Trust Fund payments in terms of future disbursements from that account.

It might be more appropriate to review the system of special charges at the time of the six-monthly review of overdue obligations, rather than at the time of the discussion of the Fund's income position, Mrs. Walker commented. That timing would be particularly useful as the evaluation of the system of special charges would be closely linked to the Board's assessment of the overdue payments situation and its procedures to deal with that situation. Furthermore, special charges would not be included in Fund income projections. Could the staff indicate whether the decision on special charges on Trust Fund obligations included overdue interest payments from resources to be disbursed from the new facility to be established? Finally, she favored retaining Section I of the decision on overdue repurchases.

Mr. Pérez reiterated his concerns expressed at a previous Board meeting that a system of special charges must be understood by members as being a device exclusively designed to recover the financial costs arising from overdue payments to the Fund. The existence of punitive action would be a negative element of the system and could aggravate the payments situation of some already heavily indebted countries. He was therefore

opposed to any system that would include the use of penalty charges. Option B in the earlier staff paper (EBS/85/242) implied the use of penalty charges, as those countries that were in arrears primarily to the General Department would be paying eight times the strict financial cost of those resources. Mr. Zecchini's proposal also implied the use of penalty charges. A formula along the lines of Option A seemed appropriate, although lower rates of charge should be applied to Trust Fund repayments in order to reflect the concessional nature of those resources. As most of his concerns had been addressed in the revised Option A, he could support the proposed decision. In conveying the decision to those countries that could be subject to the payment of special charges, it should be emphasized that the decision responded strictly to financial considerations and should in no way be interpreted as punitive action.

The Deputy Treasurer stated that the staff did not feel strongly about whether the operations of the system of special charges were reviewed at the time of the six-monthly review of overdue obligations or at the time of the review of the Fund's income position. However, two considerations should be kept in mind. First, the system could potentially have implications for the Fund's income that might need to be taken into account in the course of the review of the Fund's income position. Second, the timing of the six-monthly review of overdue obligations had been somewhat variable owing to logistical problems, whereas the scheduling of the income reviews was determined by the need for the Executive Board to take a decision on the level of charges. A link to the income reviews might therefore provide greater certainty as to timing.

Mr. Jiang indicated that he could go along with the majority view, although he had serious reservations about the proposed decision. The evidence was convincing that many member countries had delayed payments to the Fund because of their extremely difficult economic situation, which had been due in most cases to adverse exogenous factors. He doubted whether a system of special charges would encourage members to become current to the Fund. The only way to solve the problem of overdue financial obligations in a constructive way was for the Fund to study, on a case-by-case basis, the underlying causes of those overdue obligations and help member countries to formulate and implement growth-oriented adjustment policies.

Mr. Alfidja remarked that he was opposed to the proposed decision. A system of special charges would only exacerbate the already difficult financial situation of countries in arrears and would not provide incentives for prompt repayment. He basically agreed with the views expressed by Mr. Abdallah on the subject of special charges. Furthermore, the Fund had the responsibility to be involved more positively in any solution that could solve the current debt crisis, one aspect of which was the buildup of arrears to the Fund.

Mr. Arias reiterated his authorities' total opposition to the introduction of a system of special charges because such a system would make it more difficult for countries in arrears to settle their overdue obligations.

Mr. Alhaimus remarked that he had some doubts about the desirability of introducing a system of special charges. Nevertheless, as the principle of such a system had already been adopted, he could go along with the modalities as set out in the draft decision.

Mr. Vasudevan reminded Directors that his chair had consistently expressed serious doubts about the effectiveness of special charges as a means of encouraging members with overdue obligations and facing serious balance of payments difficulties to become current with the Fund. The report of the Group of Twenty-Four had suggested that the problem of overdue obligations should be resolved through new mechanisms and constructive approaches, as the countries in arrears faced serious structural problems and were often subject to exogenous shocks. In those circumstances, the imposition of special charges would only add to their payment's burden. He remained unconvinced of the advisability of introducing a system of special charges.

However, the Executive Board at its previous discussion on the issue had agreed in principle to the introduction of special charges, with the majority of Directors favoring a modified version of Option A, Mr. Vasudevan recalled. The idea for a system of special charges arose out of the general feeling that overdue financial obligations to the Fund were rising rapidly and were likely, if unchecked, to jeopardize the Fund's income position and financial integrity. However, it had not been established, either by the staff or the Executive Board, that special charges would effectively resolve the problem of overdue obligations. Furthermore, it had not been demonstrated that receipts from special charges would be obtained with certainty within a short time and that special charges would encourage members to clear their arrears quickly. Members were aware that nonfulfillment of their obligations could lead to restrictions on their use of Fund resources and, in extreme cases, to a declaration of ineligibility. It was difficult to understand how special charges could encourage members in arrears to the Fund to be current more quickly than the incentives already outlined in the Articles of Agreement.

The proposed structure of special charges was based on the "commercial" principle of recovering the estimated financial losses incurred by the Fund as a result of the overdue financial obligations, Mr. Vasudevan noted. If no account were taken of the waiver clause in Section IV of the proposed decision, special charges would be no different from other revenue items having an impact on the Fund's income position. Special charges did not help to resolve the problem of overdue obligations, and they did not take into account any of the special circumstances facing the individual member in arrears. The staff paper did not attempt to make distinctions among members in arrears. Some members had incurred arrears owing to factors beyond their control. Had these members' quotas

been higher, they would have benefited a great deal. Such members should not be treated the same way as those members that fell into arrears because they continued to pursue policies that did not bring about the necessary adjustment to their balance of payments position.

The proposed decision provided for reviews at the time of the Executive Board's consideration of the Fund's income position, Mr. Vasudevan observed. Since the idea for a system of special charges was based on the need to ensure that overdue obligations did not jeopardize the Fund's income position, it would be appropriate to eliminate the system or reduce special charges substantially when the Fund's income position improved. Those possibilities should be spelled out in detail at the time of the review. The proposed decision also provided for a waiver of special charges if the obligation was discharged within 10 business days after the due date. As communication with some members within that time was impossible, the Fund should be flexible and allow the member the benefit of a waiver if the obligations were settled within one month. The proposed decision should indicate clearly that revenues from special charges would not be reflected in the income projections for the Fund.

The SDR interest rate had been used as a proxy for determining special charges, reflecting the income forgone by the Fund on account of arrears, Mr. Vasudevan noted. Many Directors favored the use of the SDR rate on the basis of the opportunity cost principle. That principle should also be seen from the viewpoint of the members in arrears to the Fund. It would be wrong to suggest that members in arrears had an advantage in not discharging their obligations to the Fund on time and by clearing other obligations first or by investing their resources in international markets. Given the market perception that members could borrow only when their relations with the Fund were normal, there was no advantage in clearing non-Fund debt first. In fact, the loss of creditworthiness of a member in arrears to the Fund acted as a deterrent. Recent experience demonstrated that countries with overdue obligations were eager to come to understandings with the Fund on an arrangement and with the main donors for bridge financing.

Special charges that were based on the SDR interest rate would be onerous for countries with serious balance of payments difficulties and with overdue obligations to the Fund, Mr. Vasudevan considered. Furthermore, special charges hardly promoted international cooperation. The Fund had a favorable liquidity position that could meet the demands of members experiencing difficulties that might wish to make use of the Fund's resources. Moreover, it would be administratively burdensome to base the system on the SDR interest rate which changed from one week to the next. If the SDR interest rate were to increase to levels of a few years ago, the burden of special charges on members in arrears would be enormous. A cap on special charges should be established well below the present SDR interest rate in order to indicate to members that the cost of borrowing would increase if payments were not made on time. The success of such a system based on a fixed rate of special charge in alleviating the problem of overdue payments and its practical applications could then be analyzed.



As those members that had made use of the Trust Fund resources were the poor, low-income countries that were not normally borrowers of funds in the international markets, they should not be subjected to any additional charges that would remove the concessional element of those resources, Mr. Vasudevan considered. The rate of special charges to be applied to overdue Trust Fund payments could be double the normal rate of interest on repayment of Trust Fund loans of 0.5 percent a year. The effective rate of charge proposed by the staff was too high and could be seen as a penalty charge. If the SDR interest rate were to increase, the rate of special charge applied to Trust Fund obligations would be so high as to eliminate any concessional element.

Most Executive Directors had agreed at the previous discussion on the Fund's income position that members that had paid additional charges owing to the existence of deferred periodic charges should be compensated for those additional charges when the members in arrears cleared their obligations, Mr. Vasudevan recalled. Under the proposed system of special charges, members in arrears were obliged to pay the special charges as soon as they became overdue. When those members cleared their obligations would they receive those special charges that they had paid? If not, it seemed that the system of special charges included an element of penalty.

Mr. Pickering stated that he supported the proposed decision. He agreed with Mr. Zecchini that there was some asymmetry in the proposed decision, as there would be some implied financial incentive to remain in arrears to the Fund when the SDR rate of interest was less than the rate of charge. However, that issue could be addressed by the staff at the time of the first review of the decision, at which time the Executive Board would be in a better position to see whether the rate of charge would continue to exceed the SDR rate of interest. The first review of the decision should perhaps be held at the time of the Fund's income review, which was held on a more regular basis. In the future, it might be necessary for the Executive Board to hold the six-monthly review of overdue obligations at the same time as the reviews of the system of special charges and the Fund's income position.

Mr. Hubloue commented that at the previous discussion on the system of special charges his chair had favored Option B. However, in order to facilitate reaching a decision, he could support the proposed decision based on Option A. The review of the system of special charges should be held at the time of the review of the Fund's income position. An annex providing information on the system of special charges could be attached to the six-monthly report on overdue obligations.

Mr. Foot noted that the proposal for a system of special charges was far from perfect. Nevertheless, it was infinitely better than taking no action at all. At the time of the first review of the decision, Directors would have the opportunity to study the experience under the system and discuss the particular modalities of the system.

Mr. Nebbia remarked that he continued to oppose the introduction of a system of special charges.

The Deputy Treasurer stated that the special charges paid by a member would not be returned to that member when it became current with the Fund. However, it was possible that special charges would be returned in some way to the membership as a whole if they raised the Fund's income above the target for reserves.

The staff had used the SDR rate of interest to represent the financial cost to the Fund of overdue repurchases and charges, the Deputy Treasurer commented, on the basis of the analysis and discussion on earlier occasions. However, the staff would look at that question again at the time of the review of special charges.

The timing of the six-monthly review of overdue obligations was a product of the timing of the first consideration by the Board of the question of overdue obligations, the Deputy Treasurer indicated. Recently, those reviews had coincided very closely with the Board's review of the Fund's income position. It was possible that the review of the system of special charges could be held at the time of those reviews or at least about the same time.

The Deputy General Counsel commented in response to Mr. Polak that it would be better to adopt the entire decision, rather than delete Section I, which would eventually have to be adopted in the future if the SDR interest rate increased above the rate of charge. While the Fund did operate in a different and separate capacity, as a trustee, with respect to the Trust Fund, it had seemed more efficient to the drafters to include the separate paragraphs on overdue obligations to the General Resources Account and to the Trust Fund in a single decision.

Mr. Sengupta remarked that if the Executive Board considered it necessary to discuss whether the SDR interest rate truly reflected the opportunity cost to the Fund of overdue obligations at the time of the first review, it seemed that the entire basis on which the staff paper had been presented and the system of special charges established was unfounded. It was necessary to determine the opportunity cost to the Fund, before introducing a system of special charges.

Mr. Pickering stated that he agreed with Mr. Foot's earlier point that the system of special charges was imperfect and that the Executive Board should consider the operations of the system at the time of the forthcoming review. The Executive Board could re-examine at that time whether special charges should be based on the SDR rate of interest. Furthermore, Mr. Zecchini had pointed out certain asymmetries in the system which the staff should address at the time of the review.

Mr. Sengupta remarked that the Executive Board would never be able to determine at any point in time the exact opportunity cost of overdue obligations to the Fund. Mr. Zecchini's point that the higher of the SDR

interest rate and the normal rate of charge should be applied to overdue obligations, was understandable in order to discourage members from becoming overdue. If the Executive Board did not agree that the SDR interest rate represented the opportunity cost to the Fund, then the whole question of a system of special charges should be reconsidered.

Mr. Goos stated that he agreed with Mr. Foot that the decision should be taken today and the operations of the system further examined at the time of the review, when a number of issues could be addressed, including the possibility of recovering the administrative costs to the Fund.

Mrs. Walker indicated her agreement with Mr. Goos.

The Deputy Treasurer commented that there was a certain asymmetry in the system when the SDR interest rate was below the normal rate of charge, as there would be no special charges on overdue repurchases of ordinary resources. It was not an asymmetry that stemmed from the measurement of the cost to the Fund of overdue obligations; it was an asymmetry in terms of the other objectives that might be given to a system of special charges. Executive Directors had discussed in some detail whether the SDR interest rate represented a reasonable measure of the cost to the Fund of overdue obligations at EBM/85/89 and EBM/85/90 (6/5/85). The staff had based its proposal on the outcome of that discussion.

The Executive Board took the following decision:

Section I. Overdue Repurchases

1. Pursuant to Rule I-6(8) the Fund has reviewed the rates of charge to be levied under Article V, Section 8(c) on its holdings of a member's currency that have not been repurchased in accordance with the requirements of the Articles or decisions of the Fund.

2. Within three business days after (i) the due date for the repurchase by a member of the Fund's holdings of its currency resulting from purchases of the Fund's ordinary resources or (ii) the effective date of this Decision, whichever is the later, the Fund shall consult with the member on the reduction of the Fund's holdings of the member's currency that should have been repurchased. The consultation shall take place by rapid means of communication.

3. Unless the Fund's holdings of the member's currency are reduced within the period referred to in Section IV below by the amount that should have been repurchased, the rate of charge on the holdings that should have been repurchased shall be increased by a percentage equal to the excess, if any, of the rate of interest on the SDR over the rate of charge levied on the holdings under Rule I-6(4) or (11).

Section II. Overdue Charges in the General Resources Account

A special charge equal to the rate of interest on the SDR shall be paid by a member on the unpaid amount of charges owed by it under Article V, Section 8(a) and (b).

Section III. Overdue Interest and Repayments on Trust Fund Loans

The Fund shall levy a special charge on (i) the amount of overdue interest on Trust Fund loans, at a rate equal to one half of the difference between the rate of interest on Trust Fund loans and the rate of interest on the SDR, and (ii) the overdue amounts of repayments of Trust Fund loans, at a rate equal to one half of the difference between the rate of interest on Trust Fund loans and the rate of interest on the SDR, less one half percent.

Section IV. Waiver of Special Charges

Special charges under Sections I, II, and III above shall be levied in respect of an overdue financial obligation as of the due date or the effective date of this Decision, whichever is the later, unless the obligation is discharged within ten business days after the applicable date.

Section V. Notification and Payment of Special Charges

1. Special charges levied under this Decision shall be payable following the end of each of the Fund's financial quarters and the member shall be notified promptly of any special charges due. The charges shall be payable on the third business day following the dispatch of the notification.

2. Special charges in respect of overdue repurchases and charges in the General Resources Account shall be paid in SDRs to that Account. Special charges in respect of overdue repayments and interest on Trust Fund loans shall be paid in U.S. dollars to the Special Disbursement Account.

Section VI. Entry into Effect and Review

This Decision will enter into effect on February 1, 1986. It will be reviewed shortly after October 31, 1986 at the time of the midyear review of the Fund's income position for the financial year ending April 30, 1987, and thereafter annually in connection with the annual reviews of the Fund's income position.

Decision No. 8165-(85/189) G/TR, adopted  
December 30, 1985

APPROVED: AUGUST 15, 1986

JOSEPH W. LANG, JR.  
Acting Secretary

