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Measures to Deal with Overdue Financial Obligations to the IMF

The monetary character of the IMF, and the need for its resources to revolve, requires that members with financial obligations to the institution repay them as they fall due so that these resources can be made available to other members. Since the early 1980s, overdue obligations to the IMF have been a matter of great concern because they weaken the IMF's liquidity position and impose a cost on other members. The direct cost of overdue obligations to members is reflected in higher charges for all borrowers and in a lower rate of remuneration paid on remunerated reserve tranche positions.

Strengthened Cooperative Strategy

Although most of the members that have on occasion failed to meet their financial obligations to the IMF on time have corrected that situation after a relatively brief period, a few members have become overdue for substantial amounts and extended periods of time.

The IMF has developed and implemented a cooperative strategy for resolving the problem of members' protracted overdue financial obligations to it. The strategy, which was strengthened in 1990, has three main elements: prevention of new cases of arrears; intensified collaboration among the members in arrears, the IMF, and the international financial community to resolve the problem; and measures of deterrence to be taken if a country with protracted arrears fails to cooperate with the IMF to resolve its overdue obligations.

- Prevention is the key element in the IMF's cooperative strategy. In turn, the principal element of prevention is conditionality—namely, the adequacy of the economic policies and adjustment measures supported with financing from the IMF to ensure a member's ability to repay its obligations. Papers to the Executive Board containing a request to use IMF resources include an explicit assessment of the member's medium-term balance of payments viability and capacity to repay its obligations to the IMF. In recent years, significant efforts

have been made to enhance surveillance practices to improve the IMF's ability to identify, at an early stage, emerging economic and financial difficulties in member countries. The staff actively monitors the economic situation of each member that uses IMF resources. If it appears that arrears may emerge, the staff then consults with the member on possible modifications of policies or, if appropriate, the adoption of special financing arrangements to ensure that it has sufficient resources available to meet its forthcoming obligations to the IMF.

- An important aspect of intensified collaboration, the second element of the strategy, is the provision of exceptional financial assistance by creditors and donors for members in arrears that are pursuing strong growth-oriented adjustment policies. For several eligible members, the IMF has also provided for the accumulation of "rights" for future IMF financing (see below).
- Finally, the IMF has strengthened its procedures to deter the development of protracted arrears. Measures of deterrence begin with the cessation of disbursements by the IMF as soon as arrears emerge, and they proceed, if the arrears persist, through a series of steps of increasing gravity, in accordance with a timetable of agreed actions under the arrears strategy. These may include the formal consideration of the matter by the Executive Board; communications by the Managing Director with Governors of the IMF and heads of selected international financial institutions; a declaration of the member's ineligibility to use the IMF's resources; a declaration of noncooperation with the IMF; and, since the entry into force of the Third Amendment in 1992, the suspension of a member's voting rights. While the first two steps involve internal or private communications, the remaining three actions are publicized. The final step would be the initiation of procedures for the compulsory withdrawal of the member from the IMF.

The cooperative strategy has successfully reduced the number of cases of arrears, both short-term and protracted, and the volume of arrears to the IMF. It is anticipated that the vigorous pursuit of this strategy will lead eventually to the successful resolution of the remaining arrears cases. The total amount of the IMF's claims on members that are six months or more overdue is indicated in the *Annual Report* and the financial statements of the IMF, together with a list of the relevant members and the amounts and duration of each member's overdue obligations.

Third Amendment of the IMF's Articles

The Third Amendment of the Articles, which entered into force on November 11, 1992, stipulates that a member that has been declared ineligible to use the general resources of the IMF and that persists in its failure to fulfill any of its obligations under the Articles can have its voting and certain related rights suspended by an Executive Board decision with a 70 percent majority of the total voting power. Suspension is an additional sanction under the Articles that provides an intermediate measure between a declaration of ineligibility and compulsory withdrawal. As of April 1998, the Executive Board had suspended the voting and related rights of two members in protracted arrears to the IMF—the Democratic Republic of the Congo and Sudan. The Board may, by a 70 percent majority of the total voting power, terminate a suspension at any time.

The Rights Approach

For members with protracted arrears, the IMF since 1990 has followed an approach whereby a member, while still in arrears, may accumulate *rights* toward a future disbursement from the IMF on the basis of sustained performance under an IMF-monitored adjustment program. The availability of the rights approach has been limited to those 11 members that had protracted arrears to the IMF at the end of 1989 and that had adopted a comprehensive economic program endorsed by the Executive Board. Eight of the members then in protracted arrears have since become current with the IMF, three through the rights approach and the other five through other arrangements. The Executive Board has extended the availability period of the rights approach for the three remaining eligible members until the Spring 1999 meeting of the Interim Committee.⁷¹

Rights accumulation programs adhere to the macroeconomic and structural policy standards associated with programs supported by Extended and ESAF Arrangements, and performance is monitored quarterly. In particular, the programs are based on policies that help create the conditions for sustained growth and substantial progress toward external viability.

⁷¹Nevertheless, the future of the rights approach and the Second Special Contingent Account (SCA-2) (see below) would be considered earlier, as appropriate, in light of ongoing discussions on funding for the interim ESAF and the HIPC Initiative.

These programs and policies may need to be accompanied by exceptional support from creditors and donors. The member is also expected to make maximum efforts to reduce its outstanding overdue obligations to the IMF during the period of the program. However, it has been envisaged that, where necessary, rights can be accumulated up to the equivalent of the overdue obligations to the IMF that were outstanding at the beginning of the program.

Upon completion of a rights accumulation program, clearance of the member's arrears to the IMF, and approval by the IMF of a successor arrangement, the member is able to encash its accumulated rights as the first disbursement under the successor financial arrangement. Since the adoption of the rights approach through June 30, 1998, Peru, Sierra Leone, and Zambia have completed rights accumulation programs, cleared their overdue obligations to the IMF with the assistance of bridge loans from other members, and encashed their accumulated rights. Successor arrangements have taken the form of either Extended or SAF and ESAF Arrangements.

In February 1993, the IMF pledged up to 3 million ounces of its gold holdings, if needed, as additional security for use of the resources of the ESAF Trust in the encashment of accumulated rights.⁷²

Strengthening the IMF's Financial Position

During the early to mid-1980s, the IMF's financial position began to be affected significantly by the failure of some members to settle their financial obligations to the IMF when they fell due. To avoid an overstatement of actual income, the Executive Board decided in March 1985 that charges due but not settled from members in arrears to the IMF for six months or more were to be reported as deferred, rather than current, income. Since that time, charges accrued from those members and not paid are excluded from income unless the member becomes current in paying its charges.

Since May 1986, the financial consequences of overdue obligations to the IMF have, to the extent possible, been shared equally between debtor and creditor member countries (*burden sharing*). Under the burden-sharing mechanism, the rate of charge is increased, and the rate of remuneration is reduced, so as to generate enough resources to offset income

⁷²See Appendix I.

forgone as a result of the deferral of charges. However, the average rate of remuneration for an adjustment period cannot be reduced to less than 85 percent of the SDR interest rate for the purpose of generating resources to offset deferred charges and to contribute to the First Special Contingent Account (SCA-1; see below), unless the Executive Board so decides. In any case, under the IMF's Articles, the rate of remuneration cannot fall to less than 80 percent of the SDR interest rate. When deferred charges are settled by members in protracted arrears, equivalent amounts are distributed to members that previously paid higher charges or received reduced remuneration.

The IMF levies additional special charges on overdue obligations. For overdue obligations to the IMF (in the GRA or SDA), special charges apply only to members whose arrears are of less than six months' duration.⁷³ The rate of special charge on overdue charges in the GRA is set equal to the SDR interest rate, while the rate of special charge on overdue repurchases is set equal to the positive margin, if any, between the SDR interest rate and the basic rate of charge.⁷⁴ A reduced rate of additional interest is levied on overdue Trust Fund and SAF obligations. In accordance with provisions of the ESAF Trust Instrument, overdue interest or overdue loan repayments to the ESAF Trust are charged interest at the SDR interest rate (instead of the rate of $\frac{1}{2}$ of 1 percent on ESAF loans).

To further strengthen its financial position, in view of the existence of overdue obligations, the IMF established the first Special Contingent Account at the end of financial year 1987 and placed SDR 26.5 million into this account. Since then, precautionary balances held in the account have been further increased by the equivalent of 5 percent of the IMF's reserves at the beginning of each financial year. Additions to the account are generated by quarterly adjustments to the rate of charge and the rate of remuneration under the burden-sharing mechanism, resulting in equal contributions by debtor and creditor member countries. Balances in the account are to be distributed to the members that shared in the cost of financing them when there are no longer overdue charges or repurchases, or sooner

⁷³Special charges are limited to members with arrears of less than six months because these charges may have an incentive effect at early stages of arrears, but in the longer run they may add to the problem of members' overdue obligations, making eventual settlement more difficult.

⁷⁴Since May 1993, the basic rate of charge has exceeded the SDR interest rate. As a result, no special charges on overdue repurchases have been levied.

if the IMF so decides. A total of SDR 883.9 million was held in the First Special Contingent Account as of April 30, 1998.

In the context of the strengthened arrears strategy, the IMF extended, effective July 1, 1990, the burden-sharing mechanism among debtors and creditors to provide additional liquidity and to protect against risks associated with outstanding purchases arising from the encashment of rights under the rights approach. This extension was designed to accumulate SDR 1 billion in the Second Special Contingent Account (SCA-2) to be financed through further adjustments to the rates of charge and remuneration so that creditor and debtor members would contribute to the account in a ratio of 3 to 1. Because the target of SDR 1 billion was met in February 1997, these additional quarterly adjustments to the rates of charge and remuneration were terminated as of the end of the 1997 financial year. When all outstanding purchases relating to the encashment of rights have been repurchased, or sooner if the IMF so decides, accumulated amounts in the account will be distributed to members that paid higher charges or received reduced remuneration. In addition, if the rights approach were terminated, balances in the SCA-2 in excess of outstanding purchases relating to the encashment of rights would be refunded to contributors.