

DOCUMENT OF INTERNATIONAL MONETARY FUND AND NOT FOR PUBLIC USE

EBS/80/190
Correction 1

CONFIDENTIAL

October 27, 1980

To: Members of the Executive Board
From: The Secretary
Subject: Review of Fund Policies and Procedures on Payments Arrears

The following correction has been made in EBS/80/190 (8/27/80):

Page 13, para. 3, last two lines: for "it may be sufficient,...outstanding arrears" read "it may not be possible, in the early stages of the program, to reach an understanding with the member that goes beyond requiring the avoidance of any further increase in arrears.

A corrected page is attached.

Att: (1)

understandings or targets with respect to the reduction of arrears as well as to the avoidance of any new arrears during the program period. For programs relating to the first credit tranche, letters of intent generally included a statement by the member that arrears would not exceed a certain level, or that they would not be allowed to recur during the program period. In most upper credit tranche programs, performance criteria provided for a phased reduction of arrears. Furthermore, the elimination of arrears was generally regarded as a very significant step to be taken by the member in reducing its reliance on exchange restrictions. In one important respect, however, the objectives specified by the Executive Board in 1970 have proved difficult to meet. In a number of countries with Fund supported programs it has not been possible to aim at the complete elimination of arrears over the program period, reflecting the large amounts outstanding and the continuing pressures on the balance of payments which severely limited the amount of exchange available for the liquidation of arrears. In a number of cases, there were also problems of obtaining adequate data on arrears and of establishing effective institutional arrangements for their elimination. This experience has shown that a more flexible approach may be preferable whereby members will not be expected to eliminate arrears over the life of a one-year program, although normally it should remain an objective of programs covering two or three years. As a minimum effort, however, members would be expected to observe a requirement to avoid any further increase in outstanding arrears.

In any program to phase out arrears on payments to service external debt, the following additional issues arise. Such arrears usually relate to overdue payments on external public debt, covering both interest and principal. A number of the countries with arrears shown in Table 1 had arrears relating to official debt obligations, and for some of them, progress in eliminating arrears has been dependent, in part, on their success in arranging for debt rescheduling. In recent years there has been increasing resort to the funding of arrears through such arrangements by rescheduling debt payments under a multilateral arrangement such as the Paris Club, or by way of a bilateral rescheduling of arrears. The rescheduling of debt obligations has been associated with several recent programs supported by use of the Fund's resources. While permitting the member a measure of debt relief, such reschedulings in very difficult cases also allow the country concerned to re-enter the capital market and to achieve an increased import flow to assist economic recovery. Issues relating to debt renegotiation will be dealt with in a forthcoming staff paper.

VII. Conclusions

1. In the decade since the Executive Board last reviewed the Fund's policies and procedures on payments arrears, there has been a substantial increase in the number of countries incurring payments arrears and in the total amount of arrears outstanding. The widespread nature of the problem of arrears is a manifestation of the sustained payments pressures and resulting adjustment difficulties experienced by many countries in recent years. The Fund's concern with these developments stems not only from the harmful effects on

creditor countries and their deleterious consequences for the credit standing of the members incurring them, but also from their injurious effects on the smooth functioning of the international trade and payments system.

2. Through the exercise of its approval jurisdiction, the Fund's policies on payments arrears are concerned with exchange restrictions within the meaning of Article VIII, Section 2(a) which arise from governmentally imposed delays on payments and transfers for current international transactions. Because of the damaging effects of arrears on the international trade and payments system, the Fund does not grant approval to payments arrears which are exchange restrictions within the meaning of Article VIII, Section 2, except where the member has presented a program for the reduction and/or the eventual elimination of such arrears. When payments arrears are incurred by a government or by a government entity, the financial operations of which clearly form part of the budgetary process, and in those cases in which arrears arise because a country belonging to a common central bank is unable to obtain domestic currency in order to purchase required foreign exchange, the arrears should be treated as defaults and not as exchange restrictions within the meaning of Article VIII. In the settlement of payments arrears, member countries should observe the principle of nondiscrimination as regards creditor countries.

3. The Fund's policies on payments arrears are also concerned with their treatment in the context of stabilization programs supported by use of the Fund's resources. In these programs, member countries are expected to take steps to reduce and eventually eliminate payments arrears relating to capital transactions as well as to payments and transfers for current international transactions. In formulating policy guidelines in these programs, the staff will continue to be guided by the approach set forth in the Executive Board decision of 1970 (Decision No. 3153-(70/95)), as quoted on pp. 12. This approach will also be followed with respect to payments arrears arising from default. The technique chosen by a member to reduce outstanding arrears will reflect its institutional arrangements, as well as the magnitude of the arrears and the severity of the balance of payments problem. When payments arrears are large in relation to a member's available foreign exchange resources, it may not be possible to aim at the elimination of the arrears within the program period. Special arrangements may be needed for the renegotiation of outstanding debt obligations when debt problems are particularly severe. Depending on the member's circumstances and the length of the program, it may not be possible, in the early stages of a program, to reach an understanding with the member that goes beyond requiring the avoidance of any further increase in arrears.

4. There has at times been uncertainty as to the circumstances in which a delay resulting from a governmental limitation on, or interference with, the availability of foreign exchange would constitute an undue delay and thereby give rise to payments arrears. A flexible and pragmatic approach would seem to be appropriate, whereby an undue delay would be defined as one that exceeds the period reasonably needed to complete the administrative procedures required to establish the bona fides of an application for foreign exchange, having regard to the circumstances of the member concerned.