

VII The Urgent Problem of Clearing Existing Multilateral Arrears

Improving the Rights Approach in the IMF

Until 1988, countries cleared arrears to the Fund using their own foreign exchange reserves, supplemented as necessary by bridging loans from OECD central banks or (more expensively) commercial banks. In April 1988, the IMF Board agreed that countries which became ineligible for IMF loans because of accumulated arrears should follow 'shadow adjustment programmes' for a year, while they cleared arrears. At the same time, donors established Support Groups to provide additional balance of payments support to clear arrears to the Fund – or to stabilise them until a bridging loan was arranged. The first such arrangement was for Guyana in 1989, where donors placed funds in an account administered by the IMF (and the Bank for International Settlements – BIS – provided a bridging loan) to clear IMF, World Bank and Caribbean Development Bank arrears, while the Fund and Bank monitored a shadow programme for a year without any accompanying lending. Though Guyana successfully cleared its arrears in June 1990, a new programme was financed by the IMF having to grant 170% access to ESAF and standby resources, with tranches from both being heavily front-loaded. The procedure was seen as: (a) an unsustainable expansion of IMF exposure to a risky country (though subsequent improvements in Guyana's balance of payments enabled it to repay); (b) a breach of the Fund principle of uniformity of treatment for access by all countries; and (c) an excessively heavy burden on donor funds.³³

For these reasons, in May 1990, the IMF adopted a new approach for countries with large protracted arrears, known as the *Rights Accumulation Programme* (RAP). Under this approach, all accumulated arrears of interest and principal upto the starting date of the RAP would be frozen for a period of 3-4 years during which countries could accumulate 'rights' to future IMF disbursements. These were to be triggered only when sufficient rights were accumulated to repay a bridging loan contracted to clear all the arrears. However, these countries still needed to remain current on all interest service payments which were due to the Fund during the period of the shadow programme being implemented.

33 For details of the pre-1988 approach, see Martin 1991; for details of support groups, see the IMF's World Economic Survey for 1991.

Eligibility for RAP was limited to countries with protracted arrears at the end of 1989.³⁴ The RAP was funded out of the General Resources Account of the IMF. The IMF has since eliminated special charges on protracted arrears – initially only for nations which were current on special charges, and then retroactively for arrears on those charges. This was agreed because countries could not afford to have arrears increasing indefinitely due to charges, and because beyond a certain level of arrears, charges had no deterrent effect. However, it means that countries which have made no progress in reducing protracted arrears (Liberia, Somalia, Sudan) pay no charges, while those accumulating small brief arrears do.

As of March 1993, three countries had ‘benefited’ from RAPs: Peru, Sierra Leone and Zambia. The experiences of Peru and Zambia are detailed in Annex 1. The RAP approach has generally been regarded as a success by the IMF and its Executive Board has extended it until April 1994. However, the design of the IMF’s RAPs could be improved in three specific ways:

- (a) *Removal of the Interest Payment Requirement during the RAP period:* Interest charges have accounted for 25-35% of total arrears under the three RAPs. Though special charges have been eliminated and penalty charges have not been introduced, ordinary interest has continued to accrue on all arrears (including interest at the upper tranche level of 6-7% on overdue SAF and ESAF credits). As noted above, countries undergoing RAPs have been expected to pay this during the RAP in order to maintain arrears at the pre-RAP level. This requirement imposes an unnecessarily onerous burden on the beneficiary of a RAP and has required resort to external donor funding to repay the Fund. All interest accruing during the RAP could either be waived during each quarter in which RAP conditions are implemented or, alternatively, interest could be capitalised and refinanced on ESAF terms. Such measures could be backdated to the start of existing RAPs, or of RAP-equivalent shadow programmes before the RAP approach was agreed.
- (b) *Suspending Current Debt Service during the RAP:* Under existing RAP rules, the country has to keep current on its debt service obligations to the Fund, while receiving no new disbursements – resulting in large negative net transfers to the Fund which have to be financed by other multilaterals or by bilateral donors. In 1991-92 Zambia was unable to keep current on these payments (when its RAP was suspended) although Peru and Sierra Leone (and Zambia since 1992) have paid on schedule. However, bilateral donors should not be expected to compensate for this negative net

³⁴ Cambodia, Guyana, Honduras, Liberia, Panama, Peru, Sierra Leone, Somalia, Sudan, Vietnam and Zambia.

transfer to the IMF during the RAP by diverting more concessional resources to meet debt service obligations to the Fund. Ways of dealing more realistically with current debt service obligations could easily be found. For example, when the RAP was being established, Fund management proposed using:

- SDR 600 million of leftover SAF funds;
- SDR 725 million from widening the spread between charges to borrowers of SDRs and remuneration to lenders of SDRs; and,
- using funds that the IMF has accumulated in a 'burden-sharing mechanism' to offset income deferred as a result of arrears. By the end of 1992 this amount exceeded SDR 2 billion; as arrears are cleared and income received, it could be recycled.

These suggestions could be revived and used for current and future RAPs, without any damage to the Fund's balance sheet and would relieve excessive demands being made on donor aid funds at a difficult time.

The publicity for the RAP has obscured the fact that since 1990, only one country (Peru) has cleared arrears using a RAP, while three (Cambodia, Guyana, Honduras) have had to resort to organising donor support groups and another two (Panama, Vietnam) have had to use their own reserves or organise bridging loans to reduce or clear arrears. Sudan has made little progress on reducing arrears, despite intensive discussions with the Fund. Liberia and Somalia have had few discussions on how to reduce arrears, given their internal security problems.

Five new cases of protracted arrears to the IMF have emerged since 1991: Bosnia-Herzegovina, the Federal Republic of Yugoslavia (Serbia/Montenegro), Haiti, Iraq, and Zaire. These new countries are not eligible for the RAP. For the vast majority of countries in arrears, Fund procedures are no more flexible, and the RAP remains a last resort for use only when new Fund disbursements are too small to repay bridging loans.

However, the Fund has been more flexible for the limited number of countries with protracted arrears which have made no attempt to adopt essential adjustment programmes (Liberia, Sudan and Zaire). In these cases the Fund has issued 'declarations of non-cooperation'. It has consistently postponed suspension of voting rights and ultimately of membership for these countries, because such a step is regarded by many Board members as a negative move which could only be counter-productive and because they have at various stages made apparent moves to reduce arrears or suffered from major internal security breakdowns. However, in late 1993 the suspension of Sudan has become a live issue and may be acted upon.

Given the success of the rights approach in Peru and the resulting recent fall in total arrears to the Fund, there is no consensus among Fund Board or management as to whether further steps need to be taken to alleviate the

arrears problem of other countries' obligations to the IMF. However, the Zambia RAP is again in trouble and it is doubtful whether other RAPs will be as successful as that of Peru. More drastic measures may well be needed for Liberia, Somalia and Sudan should they agree to Fund programmes and try to clear arrears, because their arrears range between 400% and 700% of their present quotas. Thus, under existing rules, there is no way that the Fund could, in the foreseeable future, provide them with sufficient resources to clear these arrears.

Hidden Rescheduling and Refinancing by the World Bank

The amounts of arrears owed to the World Bank have hitherto been small enough to be cleared using donor aid, or overnight commercial bank bridging loans which are immediately repaid by new Bank disbursements. During 1990-91, Nicaragua, Panama, Sierra Leone and Zambia cleared their arrears using these methods.

In May 1991, the Bank introduced a programme of 'Additional Support for Workout Programs in Countries with Protracted Arrears'. As with the IMF's RAP, under the Bank's programme the eligible country accumulates rights to disbursements during a 'performance period'. Actual disbursements are only made upon clearance of arrears to the Bank. The only substantive difference between the two approaches is that the Bank's Executive Board is able to approve commitments of loans to the country during the 'performance period', before arrears are cleared. Countries do not necessarily have to clear their arrears in 'parallel' (i.e. simultaneously) to the IMF and World Bank. But in those cases where parallel clearance is agreed (as it was in Peru), the Bank's 'performance period' is of the same length as the RAP. However, in the cases of Sierra Leone and Zambia, arrears to the Bank were much smaller than those to the IMF and were cleared first, using donor funds and bridging loans.

The Bank has so far applied this policy only to Peru, in July 1991. In a recent review, it was judged to be broadly successful. The Bank's approach has some major advantages over the RAP:

- (a) because non-accrual status is applied only to principal which is six months overdue, additional interest charges do not accrue on the total original principal and interest arrears.
- (b) the announcement of up-front loan approvals by the Bank's Board helps to mobilise funds from other donors and restore confidence for private sector flows.
- (c) approval of Bank loans allows funds from other donors (which are cofinancing these loans) to be disbursed before Bank arrears are cleared.

Therefore the only remaining major problem is the burden of current debt service during the 'performance period', which results in negative net transfers to the Bank. While Peru managed to pay all of this current service, it is again questionable whether bilateral donors should (or can) be expected to compensate by increasing concessional flows. Current service for future programmes could instead be funded (at least partly) by the large amounts IBRD has set aside for loan loss provisions against the possibility that arrears will not be paid. At the end of June 1993, these provisions totalled \$3.15 billion, more than 250% of arrears on loans in non-accrual status. The proportion of provisions which was related to Peruvian arrears (which have now been cleared) should now be made partly available for recycling to help other debtors pay current service without any negative effect on the IBRD balance sheet. The amount actually needed are negligible, as only in Liberia and Syria are current arrears likely to require Peru-style 'performance periods'.³⁵

Like the IMF, the World Bank has been reluctant to apply harsh punitive measures against countries with protracted arrears. On the other hand, it has been inventive in finding a way to discourage temporary arrears. In July 1991 the Bank took a positive step to encourage countries to pay IBRD within one month of the due date: a one-year waiver of 25 basis points on interest. In FY 1992, this cost the Bank \$132 million out of an estimated \$160 million which was set aside as a reduction of income. This measure is seen as highly successful and was extended through FY 1992/93.

Lack of Action on Clearing Arrears by Other Multilaterals

No other major regional multilateral institution has followed the IMF and World Bank in developing special approaches to clearing protracted arrears. On the one hand, the regional development banks (RDBs) have stayed with their conventional policy of insisting on clearance of arrears. To this end, increasing numbers of countries have been contracting bridging loans to pay off RDB arrears. Among recent examples were a loan to Peru from the Latin American Reserve Fund for clearing IDB arrears, and a bridge finance arrangement for Sierra Leone to clear its arrears to the AfDB. On the other hand, Arab multilateral institutions have gone further than the World Bank or IMF, with BADEA formally rescheduling arrears for some countries, in part because they have only received 'secondary preferred creditor' status – in other words, other creditors have been prepared to informally accept the

³⁵ In addition to these provisions, the IBRD also has a General Reserve of \$11.14 billion and a Special Reserve of \$293 million.

accumulation of arrears to them unless they are maintaining a positive net transfer to the debtor country.