

# 16

## Carrots and Sticks: Safeguarding the Fund's Resources

**T**he IMF is a cooperative membership institution with a fixed amount of money to lend. It is not a development bank with a regularly replenished pool of resources to distribute through grants or very long-term subsidized loans. The IMF lends to its members on the basis of information each country provides, and it relies on each country to pay interest and to repay principal on schedule without the possibility of recourse to bankruptcy or other judicial proceedings. Any breakdown of trust and cooperation threatens the viability of the Fund as a multilateral agency and imposes potentially large costs on all members. If one country fails to repay loans from the Fund, less money will be available for others to borrow. If a country borrows under false pretenses, the value that Fund lending adds to the global welfare could be seriously diminished. For these reasons, safeguarding the IMF's financial resources has always been a major concern.

In the 1990s, the sanctity of the Fund's finances suffered two threats.

First, a substantial number of borrowers failed to service their debts properly. At one time or another, 18 countries had protracted arrears—financial obligations six months or more behind schedule—to the Fund. The Fund devoted considerable energies to whittling away at those arrears, adopting more-flexible and more-effective policies and applying them case by case. Some of the new policies took the form of “carrots”: positive incentives to cooperate in resolving the problem. Others took the form of “sticks”: increased penalties for failing to cooperate. This potent combination, even though taking a while to work in the most difficult situations, succeeded in clearing all but two arrears cases by 2008.

Second, several countries borrowed from the Fund on the basis of false information, either deliberately or through negligence. This “misreporting” problem had never been a serious issue until this decade, so the Fund had to develop new policies and procedures to deal with it. Full resolution of this problem would take much longer than had the arrears problem.

## Payments Arrears to the Fund: Containing the Problem

At the dawn of the 1990s, the IMF was struggling to contain the spreading effects of a backlog of outstanding arrears on loans it had made in the first half of the preceding decade. Several countries had fallen behind temporarily and had managed to get current again, but none of the large or persistent cases had yet been resolved. Eleven countries had fallen behind in their obligations by at least 15 months, and all of them were still in arrears at the end of the 1980s. After nearly 40 years without any significant repayment problems, more than 14 percent of the Fund's total credit and loans outstanding were now effectively in nonperforming status (Figure 16.1). Arrears continued to accumulate, and the Fund clearly needed a new strategy if it hoped to solve the problem.

The first challenge for the IMF in its quest to cope with arrears was to assess why the problem arose in the first place. Why did some countries fail to repay loans, when others—many of them just as poor and facing problems just as great—stayed current? In several cases, the Fund had entered into arrangements in the belief that the borrowing country simply faced a temporary balance of payments need, but the shortfall later proved to be more permanent. In some cases, political shifts in the country induced the new leaders to reject responsibility for earlier debts or to seek to limit debt service to a manageable portion of export revenues. In a few cases, disputes between the indebted country and one or more large creditor countries made it difficult for the debtor to obtain foreign exchange. In other cases, a breakdown of governance and civil order temporarily severed relations between the country and the international community, including the IMF.<sup>1</sup>

The Fund's initial response when the problem arose in the 1980s was to insist that countries eliminate their arrears as a precondition for discussions of new lending or even of policy advice. The fear was that a softer approach would give rise to moral hazard and discourage countries from servicing their debts. After a few years, it became clear that the reasons for going into and staying in arrears varied greatly from one country to another and that political instability was usually an important contributing factor. In response, the Fund gradually shifted to a case-by-case strategy that encompassed a wide range of incentives, including encouragement for cooperation wherever possible.

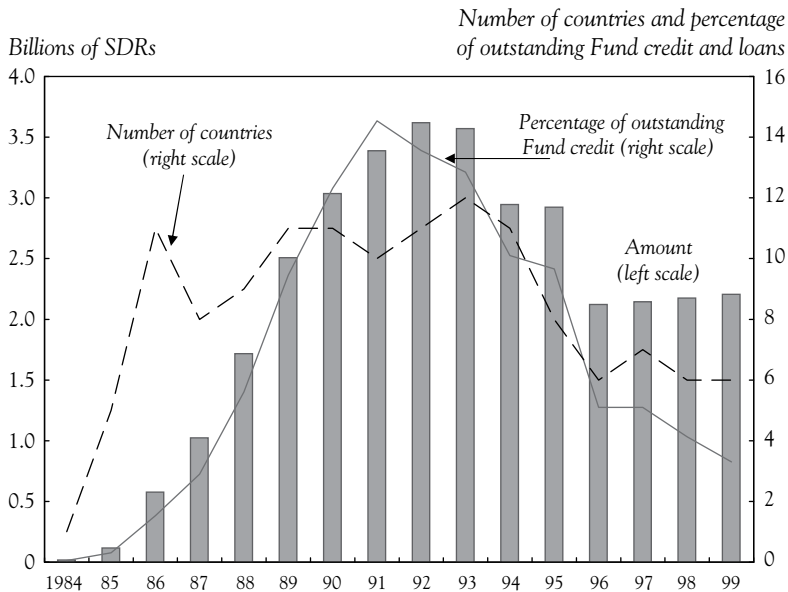
### Policy Changes: Developing a Collaborative Solution

Almost from the onset of the arrears problem in 1985, the staff and the Executive Board struggled to develop a solution that would induce countries to repay loans on time without offering incentives that would give rise to moral hazard for other

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<sup>1</sup>These issues are covered in Boughton (2001), Chapter 16.

**Figure 16.1. Protracted Arrears to the Fund, 1984–99**



Source: International Financial Statistics.

members. The Fund also began setting aside reserves to rebuild capital in view of the low quality of its loan portfolio.

In 1985, the Fund adopted a blanket prohibition against new borrowing through stand-by or extended arrangements by any country with overdue obligations. With the *1985 Annual Report*, it began publishing its declarations that specific countries with protracted arrears were ineligible to borrow. In December 1985, it began imposing surcharges (“special charges”) on the interest rate on overdue balances. In July 1986, it introduced a “burden sharing” procedure that lowered remuneration to creditors and raised interest rates paid by all borrowers so all member countries would share the risk that some loans might eventually have to be written off. A year later it established a reserve fund—the Special Contingent Account (SCA)—to provision against possible loan losses.<sup>2</sup>

The effort to develop a more flexible and cooperative approach to dealing with countries in arrears began in earnest in 1988. That spring, the Managing Director (Michel Camdessus) and the Chairman of the Interim Committee (Onno Ruding, finance minister in the Netherlands) agreed that the policy of refusing to provide policy advice to, or negotiate programs with, countries in arrears was proving to be counterproductive. The “sticks” of remedial measures to punish those countries were

<sup>2</sup>These Executive Board decisions are reproduced in the Appendix to Chapter 16 of Boughton (2001), pp. 826–32. Costs covered by the SCA included unpaid interest charges by borrowers.

still needed, but they had to be balanced with “carrots” to provide incentives for debtors to make sacrifices and get current on their repayments. In September 1988, the Interim Committee endorsed the outlines of a comprehensive three-pronged strategy to ensure all member countries would treat the IMF as a preferred creditor and make a full effort to settle and avoid arrears.

The first prong in this strategy was a renewed commitment by the staff to assess the ability of countries to implement sound policies and service their debts, and thus to try to prevent situations that would lead to arrears. The second was an intensification of deterrent measures, such as publicizing cases more extensively, withholding technical assistance, and prohibiting countries from getting quota increases. The third—which represented a real cultural shift in the Fund—was a new determination to work with the indebted countries to help them find ways to escape from and move beyond the arrears vortex.

While this “intensified collaborative approach” was still being fleshed out, arrears continued to accumulate. As shown in Figure 16.1, the total amount outstanding did not peak until 1992. The problem then diminished. By 1992, every country with protracted arrears was making at least some payments to the IMF. In five and a half years from mid-1990 to end-1995, 8 of the 11 outstanding cases from the 1980s were resolved (Table 16.1), and the total outstanding was reduced from a peak of \$5.1 billion (SDR 3.6 billion) to \$3.2 billion (SDR 2.1 billion). Four new cases arose and were already resolved. The remaining outstanding arrears were mostly associated with severe and seemingly intractable political and economic problems in four African countries—the Democratic Republic of the Congo (then known as Zaïre), Liberia, Somalia, and Sudan—that lay far beyond the ability of IMF assistance or pressure to alleviate.

The two main innovations in Fund policies on arrears in the 1990s were the establishment of the “rights approach” in 1990 and the adoption of the Third Amendment of the Articles of Agreement in 1993.

### ***Rights Accumulation Programs***

One bottleneck apparent by 1989 was that the largest outstanding arrears could be settled only with substantial grants from donor countries friendly to the debtors. Donors were reluctant to take on that burden by themselves, especially because the immediate direct benefit would be repayment to the IMF, not an increase in social spending in the indebted country. To break the bottleneck, the Fund needed some means to make its own financial contribution to the settlement of arrears. The most obvious and straightforward solution—rescheduling the loans similarly to the way the Paris Club dealt with nonperforming bilateral loans—was precluded by the Fund’s policies and was anathema to most of the Fund’s creditor members.

Informal discussions among the staff, management, and Executive Directors led to the emergence of the “rights approach” in January 1990. The basic idea, as developed by the Deputy Managing Director, Richard D. Erb, was relatively simple. If a country had arrears to the Fund and was ineligible to borrow, and if the country wanted to

cooperate with the Fund to work its way out of the problem, the Fund could agree to monitor policy implementation for a few years. It could also agree to make a provisional commitment to lend to the country at the end of that period, by allowing the country to accumulate “rights” up to the approximate level of the country’s outstanding arrears. During that time, a “support group” of donor countries would help finance the country’s balance of payments and development needs. The country would be expected to make regular payments to the Fund to keep its arrears from rising. Once the country had accumulated enough rights to settle its arrears, the Fund would approve a new stand-by or similar arrangement and immediately apply the rights in settlement of the old obligations and as an upfront disbursement under the new arrangement. These transactions would effectively reschedule the debts to the IMF and begin a fresh lending arrangement on normal terms.

The Executive Board discussed this proposal extensively in a series of meetings from late January through April 1990. The approach survived essentially intact, but with two major changes from the original proposal.

The first change was to introduce an intermediate step to separate the new arrangement from the previous one. This step obscured the fact that the Fund was engaging in a *de facto* rescheduling. At the end of the rights accumulation period, the donor support group would be expected to provide a very short-term bridge loan enabling the country to repay its outstanding obligations. Only after the country had applied the proceeds to settle its arrears would the Fund approve the new lending. The borrower could then use the initial disbursement from the Fund to repay the bridge loan, at which point all of the old balances would be fully cleared. These transactions would normally take place within a day or two, but the sequencing was viewed as essential to preserve the principle that the new arrangement was independent of the old.

The second stumbling block concerned the risk that the Fund might tie up sizeable amounts of its scarce financial resources for years while countries completed their Rights Accumulation Programs (RAPs) and that it then would disburse large sums up front to countries that might still face uncertain economic and political prospects. Approval of the program therefore became closely linked to approval of other elements of the strengthened strategy, as discussed below.

The Interim Committee endorsed the rights approach in May 1990, and the Executive Board agreed on the way in which to implement it in a series of meetings in June. The final agreement on “modalities” was adopted on June 20, 1990, not in the form of a formal decision but rather through a Summing Up of the discussion by the Managing Director.<sup>3</sup>

A central feature of the rights approach was that it was limited to the 11 countries with protracted outstanding arrears when the approach was initiated, and it was available only for a limited time. These limitations were imposed to avoid moral hazard opportunities for countries that might stop repaying the Fund in the future or that

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<sup>3</sup>This Summing Up is available at <http://www.imf.org/external/pubs/ft/history/2011/index.htm>.

**Table 16.1. Countries with Protracted Arrears to the IMF, 1990-99**  
(Millions of SDRs)

| Country  | Level of Remedial Action <sup>a</sup> | Date of Complaint <sup>b</sup> | Date of Ineligibility | Ending Date | Outstanding End-1989 | Amount of Settlement <sup>c</sup> | Outstanding End-1999 | Amount Outstanding or Settled (Percentage of Quota) |
|--|---------------------------------------|--------------------------------|-----------------------|-------------|----------------------|-----------------------------------|----------------------|---|
| A. Cases from the 1980s resolved in the 1990s    |                                       |                                |                       |             |                      |                                   |                      |   |
| Guyana   | 7                                     | 4/4/1984                       | 5/15/1985             | 6/20/1990   | 98.7                 | 107.1                             | ...                  | 218   |
| Honduras   | 7                                     | 1/30/1989                      | 11/30/1989            | 6/28/1990   | 20.6                 | 27.5                              | ...                  | 41  |
| Panama   | 7                                     | 3/3/1988                       | 6/30/1989             | 2/5/1992    | 165.7                | 180.9                             | ...                  | 177   |
| Peru   | 7                                     | 12/13/1985                     | 8/15/1986             | 3/18/1993   | 626.6                | 621.0                             | ...                  | 133   |
| Cambodia   | 5                                     | 11/17/1978                     | ...                   | 10/1/1993   | 29.3                 | 36.9                              | ...                  | 65  |
| Vietnam  | 7                                     | 7/25/1984                      | 1/15/1985             | 10/5/1993   | 102.5                | 100.2                             | ...                  | 41  |
| Sierra Leone                                     | 7                                     | 3/17/1987                      | 4/25/1988             | 3/28/1994   | 69.4                 | 85.5                              | ...                  | 111   |
| Zambia   | 7                                     | 7/18/1986                      | 9/30/1987             | 12/6/1995   | 764.9                | 830.2                             | ...                  | 318   |
| B. Cases from the 1980s that remained unresolved |                                       |                                |                       |             |                      |                                   |                      |   |
| Sudan  | 10                                    | 12/12/1984                     | 2/3/1986              | ...         | 847.5                | ...                               | 1,132.0              | 667   |
| Liberia  | 7                                     | 4/4/1985                       | 1/24/1986             | 3/14/2008   | 290.6                | ...                               | 470.0                | 659   |
| Somalia  | 8                                     | 9/8/1987                       | 5/6/1988              | ...         | 90.4                 | ...                               | 202.2                | 457   |
| C. New cases resolved during the 1990s           |                                       |                                |                       |             |                      |                                   |                      |   |
| Dominican Republic                               | 5                                     | 11/21/1990                     | ...                   | 4/23/1991   | ...                  | 24.3                              | ...                  | 22  |
| Haiti  | 5                                     | 1/21/1992                      | ...                   | 12/19/1994  | ...                  | 24.8                              | ...                  | 41  |
| Bosnia and Herzegovina                           | n.a.                                  | 10/23/1992                     | ...                   | 12/20/1995  | ...                  | 25.1                              | ...                  | 21  |
| Central African Republic                         | 5                                     | 8/6/1993                       | ...                   | 3/3/1994    | ...                  | 1.6                               | ...                  | 4   |

**Table 16.1. (continued)**

| Country  | Level of Remedial Action <sup>a</sup> | Date of Complaint <sup>b</sup> | Date of Ineligibility | Ending Date | Outstanding End-1989 | Amount of Settlement <sup>c</sup> | Outstanding End-1999 | Amount Outstanding or Settled (Percentage of Quota) |
|--|---------------------------------------|--------------------------------|-----------------------|-------------|----------------------|-----------------------------------|----------------------|---|
| D. New cases that remained unresolved in the 1990s |                                       |                                |                       |             |                      |                                   |                      |   |
| Serbia and Montenegro                              | n.a.                                  | 10/23/1992                     | ...                   | 12/20/2000  | ...                  | ...                               | 94.9                 | 42  |
| Congo, Dem. Rep. of (Zaire)                        | 9                                     | 1/29/1991                      | 9/6/1991              | 6/12/2002   | ...                  | ...                               | 375.9                | 129   |
| Iraq   | 5                                     | 1/29/1991                      | ...                   | 9/22/2004   | ...                  | ...                               | 39.9                 | 8   |
| Afghanistan, Islamic State of                      | 5                                     | 2/26/1996                      | ...                   | 2/26/2003   | ...                  | ...                               | 4.5                  | 4   |
| Total  |                                       |                                |                       |             | 3,106.2              | 2,065.1                           | 2,319.4              |   |

Sources: IMF financial accounts and staff reports.

Note: n.a. = Not applicable. Dates are in the form of month/day/year.

<sup>a</sup>Most severe action taken by the IMF through 1999, according to the 11-step timetable listed on pp. 808-09.

<sup>b</sup>With two exceptions, this is the date on which the Managing Director issued a formal complaint to Executive Directors regarding overdue obligations by the member. For Bosnia and Herzegovina and for Serbia and Montenegro, it is the date on which the Managing Director notified Executive Directors that the predecessor state, the Socialist Federal Republic of Yugoslavia, had incurred overdue obligations.

<sup>c</sup>Includes only full settlements completed by December 31, 1999. In some cases, partial payments were made before the final settlement.

might delay agreeing to a new Fund-approved policy program. Moreover, the Fund did not expect all of the eligible countries to take advantage of the plan. Guyana and Honduras were on the verge of settling their arrears and would have no need for the new program. Others were not expected to qualify in time.

Within two years, three countries—Peru, Sierra Leone, and Zambia—had embarked successfully on RAPs. As discussed more thoroughly in the next section, all three completed the process successfully, cleared their arrears by 1995 at the latest, resumed borrowing from the Fund on good terms, and serviced the new debts without further difficulty. Five other eligible countries—Cambodia, Guyana, Honduras, Panama, and Vietnam—cleared arrears in that same period without recourse to the rights approach. That left just 3 of the original 11 countries—Liberia, Somalia, and Sudan—all with long-standing domestic political problems that kept them far from qualifying for a RAP. Nonetheless, the Board held out hope by repeatedly extending the deadline for qualification. At the end of the 1990s, the rights approach was still in place, awaiting the opportunity for renewed cooperation from those three countries.<sup>4</sup>

### **Remedial Actions and the Third Amendment**

Until 1989, the IMF had few options for ratcheting up pressure on a country to settle its arrears. It could issue public declarations that the member was ineligible to borrow, but the next step would have been to expel the miscreant from membership. Because that step would usually be counterproductive and make it nearly impossible to collect the outstanding debt, the declaration of ineligibility was, for all practical purposes, the last arrow in the quiver.

In 1986, Yusuf A. Nimatallah, the Executive Director for Saudi Arabia, called for an amendment to the Articles of Agreement to allow the Fund to suspend a member's voting privileges and its right to accept quota increases. That suggestion was strongly opposed by Directors from developing countries—including the Dean of the Board, Alexandre Kafka (Brazil)—and it was quietly dropped.<sup>5</sup>

As an intermediate step, a deeply divided Executive Board approved a policy of public censure in 1989. Under this new “naming and shaming” procedure, the Fund could publicly declare a country to be failing to cooperate in efforts to resolve its problems, and the Managing Director could write directly to Governors from other interested countries and to the heads of other multilateral institutions, informing them of a country's failings.<sup>6</sup> No one expected these decisions to do much to reduce outstanding arrears. The outcome left the hawks on the Executive Board dissatisfied because too

<sup>4</sup>Liberia settled its arrears in 2008 without recourse to a RAP. Two years later, the rights approach was still in effect, pending resolution of the other two cases.

<sup>5</sup>Minutes of EBM/86/92 (June 6, 1986), pp. 8–11. The staff subsequently prepared two papers explaining the legal objections to suspending countries' membership rights under the Articles of Agreement; see “Suspension of Membership in the Fund—Legal Aspects,” SM/87/229 (August 25, 1987); and “The Issue of Suspension of Membership,” SM/89/127 (June 28, 1989).

<sup>6</sup>For the background to this decision, see Boughton (2001), pp. 815–17.



little was being achieved, and it left the doves frustrated because the emphasis was on punishment rather than assistance.

The United States revived the idea of suspending membership rights in 1990 and devised an effective strategy for getting it adopted. Amendments to the Articles of Agreement require the support of 60 percent of the membership holding 85 percent of the voting power. Therefore, amendments cannot be enacted without broad support from both industrial and developing countries. Those requirements posed a large challenge, but the U.S. authorities saw the goal as at least symbolically important. According to their Executive Director in the Fund, Thomas C. Dawson II, they

believe . . . that a country which does not live up to the obligations of membership should not be allowed to enjoy the rights and privileges associated with membership. A voice and vote in the affairs of the IMF are among the most basic rights of membership in the institution. Therefore, a strengthening of the remedial measures [on a country in arrears] should include suspension of the country's voting rights and representation on the Board of Governors, Interim Committee, and Executive Board.<sup>7</sup>

The Board debated this proposal extensively in several long days of meetings in February 1990. Although the membership was still split, with some opponents calling it unacceptable, support for it by several creditor countries was sufficiently strong to compel the staff to draft an amendment to the Articles. The Fund's Legal Department promptly did so, despite the amendment having no chance of being ratified on its own. At that point, the U.S. authorities found an irresistible linkage. After eight years of heavy lending activity in response to the debt crises of the 1980s, the IMF badly needed a replenishment of its resources through a general increase in quotas. The United States was prepared to support an increase, but now it made its support conditional. When the Executive Board discussed the draft amendment in April, Dawson informed his colleagues that the U.S. authorities would insist "that the quota resolution should provide that any quota increase will become effective only when the amendment of the Articles of Agreement providing for suspension [of voting rights] has been ratified and adopted by the necessary 85 percent majority vote."<sup>8</sup>

Few Directors embraced the U.S. linkage proposal, but they all understood that neither the quota increase (which almost everyone favored) nor the amendment could pass without U.S. support.<sup>9</sup> Even if the U.S. authorities were bluffing, the danger remained that the U.S. Congress would refuse to ratify the increase without the amendment. A narrow majority—all from creditor countries—favored amending the Articles, and now they had the leverage to force the issue.

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<sup>7</sup>"Statement by Mr. Dawson on the IMF Arrears Strategy," BUFF/90/24 (January 30, 1990), p. 4.

<sup>8</sup>Minutes of EBM/90/59 (April 16, 1990), p. 17.

<sup>9</sup>At the April 16 Board meeting, 9 of the Fund's 22 Executive Directors indicated a preference for amending the Articles, and 3 others said that they were open to the idea, but 5 of those 12 expressed doubts about making the quota increase dependent on approval of the amendment.

The Interim Committee endorsed the amendment in May 1990, and the Board of Governors approved it a month later. Only 61 percent of the membership, with 79 percent of the voting power, voted in favor, but that was enough to adopt the resolution and initiate the ratification process.<sup>10</sup> Remarkably, it had taken just five months to draft, debate, and approve a complex and highly controversial amendment.

The most arduous leg of this journey was the last. The bitterness produced by the strong-arm tactics of the majority did not quickly dissipate, and the first few months of attempts at ratification made it clear that reaching the 85 percent threshold would not be easy. Raising the rhetorical ante, Camdessus told Executive Directors in September 1990 that “what is now at stake is the life and future and the credibility of the institution.”<sup>11</sup> If the quota increase did not take effect by the end of 1991, the resolution was scheduled to lapse. Most likely, the Fund would be left without the resources to meet members' requests for loans even earlier.

The ratification process dragged on throughout 1991, at the end of which the Executive Board reluctantly agreed to extend the deadline to June 30, 1992. By April of that year, 112 members with more than two-thirds of the voting power had ratified the amendment. The main but not the only holdout was the United States, owing both to the cumbersome legislative procedures for getting all elements of the required legislation adopted on identical terms by the Senate and the House of Representatives and to the delicacy of domestic politics in a presidential election year. Finally, in the last week of October and just days before the election, the United States completed those steps and ratified the amendment.

The Third Amendment entered into force on November 11, 1992.<sup>12</sup> With this amendment, the “remedial” strategy for escalating pressure on countries in arrears was complete. It encompassed the following steps, to be taken in order:<sup>13</sup>

1. The staff sends a reminder to the authorities as soon as the payment becomes overdue. This action automatically puts any further borrowing on hold.
2. At two weeks, the Managing Director writes to the Governor for the member.
3. At one month, the Managing Director notifies the Executive Board.

<sup>10</sup>For the full results, see “Proposed Third Amendment of the Articles of Agreement—Voting Results on Board of Governors' Resolution,” SM/90/101, Revision 3, Suppl. 1 (June 29, 1990).

<sup>11</sup>Minutes of EBM/90/134 (September 5, 1990), p. 4.

<sup>12</sup>The text of the Third Amendment is available at <http://www.imf.org/external/pubs/ft/history/2011/index.htm>.

<sup>13</sup>The timetable was indicative and could be varied according to specific circumstances. These procedures applied if the arrears were to the General Department of the Fund. Slightly different procedures applied for arrears to the SDR Department or to the Fund's concessional lending facilities such as the Enhanced Structural Adjustment Facility. The original Board decisions detailing these steps are reproduced in Boughton (2001), pp. 837–43. Most of the timetable summarized here was adopted in March 1990, with some shorter intervals than in the initial policy; see “Statement by the Managing Director on the Strengthened Cooperative Strategy on Overdue Financial Obligations to the Fund,” BUFF/90/58 (March 15, 1990), pp. 13–14. The adoption of the Third Amendment further refined the timetable.

4. At six weeks, the Managing Director notifies the authorities that a formal complaint will soon be issued. At this time, but only after consulting with Executive Directors, the Managing Director might also write to some or all Governors asking for their help in resolving the matter.
5. At two months, the Managing Director issues a complaint under Rule K-1.
6. At three months, the Executive Board reviews the complaint and may formally suspend the member's right to draw on the Fund's resources until the arrears are settled in full.
7. Not more than 12 months after the emergence of arrears, the Executive Board declares the member ineligible to use Fund resources until the ban is lifted by the Board.
8. After another seven months, the Executive Board considers issuing a declaration of noncooperation.<sup>14</sup>
9. After a further "reasonable period" of noncooperation, the Executive Board—by a 70 percent majority of total voting power—may suspend the member's voting rights until such time as the Board restores those rights by the same majority.
10. Only after "all other possible avenues to redress the problem" have been exhausted, the Fund may initiate procedures leading to compulsory withdrawal.
11. Eventually, the Board of Governors—by an 85 percent majority of total voting power—may expel the member from the IMF ("require the member to withdraw").

The Fund recognized that in some cases, it might be necessary to reverse some of these steps to encourage countries to strengthen their efforts to settle arrears. In April 1992, the Executive Board agreed that a declaration of noncooperation could be withdrawn while arrears remained outstanding if the Fund determined the member was cooperating in trying to resolve the matter. In July 1999, the Board adopted more comprehensive de-escalation policies, though the policies were limited to the lifting of declarations of noncooperation and suspensions of voting rights.<sup>15</sup>

### **Other Policy Changes**

As the Fund gained experience with the intensified collaborative approach, it continued to tweak its policies. A series of mostly minor changes in the early 1990s had the combined effect of guarding against new arrears, reducing obstacles to the settlement of old arrears, and shoring up the Fund's finances if some large balances remained outstanding for a long period.

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<sup>14</sup>Consideration of a declaration of noncooperation was to be preceded by a communication sent to "all Fund governors and the heads of selected international financial institutions" within three months after step seven; see BUFF/90/58 (March 15, 1990), p. 5.

<sup>15</sup>See minutes of EBM/92/58 (April 17, 1992), p. 4; and "The Acting Chairman's Summing Up—Overdue Financial Obligations—De-Escalation of Remedial Measures under the Strengthened Cooperative Strategy—Further Considerations, Executive Board Meeting 99/79—July 22, 1999," BUFF/99/90 (July 27, 1999).

*Preventive measures.* To help prevent new problems from arising, the staff set out to strengthen its ability to analyze countries' financial capacity to service external debts and ultimately repay the Fund. Previously, the IMF had acted on the assumption that if a borrowing country strengthened its macroeconomic policies and met the conditions set out in a stand-by arrangement, it would have the capacity to repay the loan. After all, the fundamental characteristic of the Fund's "financial programming" exercise underpinning its loan conditions was a quantitative analysis of the links between macroeconomic policies and the balance of payments. The failure of several countries to service debts to the Fund in the 1980s forced the staff to consider new paradigms in which "capacity to repay" could be analyzed more directly.

Beginning in mid-1990, the policy became that every staff mission in response to a member's request to borrow should discuss the country's debt-servicing capacity with the authorities, and each staff report should include an explicit assessment of the country's capacity to repay the Fund. It also should include an assessment of possible risks that could throw the economy off track, including in the period after the Fund-supported program ended but the loan was still outstanding, and of contingency plans to deal with adverse shocks. More subtly, the staff was also asked to examine the country's record of servicing its external debts to the Fund, multilateral development banks, and other creditors. Any danger signs in this record were to be noted. In retrospect, this type of risk analysis seems quite basic, and no more than what any auditor would expect to see from a well-run financial institution. At the time, it was a notable cultural departure from the IMF's history as a membership organization in which every country was given the benefit of the doubt until a problem materialized.

One way the Fund had always tried to ensure borrowers would have the resources to repay their loans was to require borrowing countries to maintain minimum levels of official international reserves. In practice, this often meant Fund resources would simply be added to the borrower's foreign exchange reserves. Such loans were not intended to facilitate government spending directly, but rather to shore up the balance sheet so external trade could be financed more smoothly. If the country's reliability in managing its reserves was open to doubt, the Fund could ask it to accept disbursements in SDRs rather than in U.S. dollars or other convertible currencies and to hold the SDRs in the member's account at the Fund. As part of the strengthened arrears strategy in 1990, the Fund began to employ this latter tactic more widely.<sup>16</sup>

*Financial policies.* A major consequence—perhaps *the* major consequence—of the failure of some countries to service and repay their debts was the financial burden it placed on all other countries, including the poorest. The IMF responded in two ways. First, it had to increase its own reserves to cover the possibility that some loans might

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<sup>16</sup>In 1990, such arrangements were made for several countries, including Guyana, Panama, Uganda, and Zambia; see "Six-Monthly Report on Overdue Financial Obligations to the Fund—Progress under the Strengthened Cooperative Strategy," EBS/91/41 (March 12, 1991), p. 6.

never be repaid. Second, it decided to impose what amounted to (but pointedly were not called) penalty rates of interest on overdue obligations.

As recounted in the previous History, the Fund established procedures beginning in 1986 to ensure it had adequate reserves to cover potential losses on overdue obligations. Because the Fund was created as a cooperative institution with no allowance in its Articles for writing off bad debts, and because the Fund's outstanding credits are legally distinct from loan contracts, the Executive Board did not establish an account that explicitly contained provisions for loan losses. Instead, it agreed to set up an account—the Special Contingent Account (SCA)—linked more generally to the amount of outstanding balances in protracted arrears. The SCA was funded by transferring excess net income each year (i.e., income in excess of a target level set by the Board at the start of the year). That excess income would be generated by temporarily reducing remuneration paid to creditor countries and raising interest charges to debtor countries under the Fund's "burden sharing" policies. The terms of the SCA provided that it would eventually be terminated and distributed proportionally to those same creditor and debtor countries once the extra reserve was no longer needed.<sup>17</sup> In addition, the Board gradually increased the target level for net income, which was added to the Fund's general reserves. By April 1990, these actions had raised the ratio of reserves to arrears-related credits (credit outstanding to countries with arrears) from a counterfactual 48 percent (what it would have been in the absence of the policy changes) to 63 percent: an improvement, but not sufficient for comfort.

A potential constraint on the size of the SCA was a provision that the remuneration rate to creditors could not be reduced below 85 percent of the SDR interest rate. The Board had agreed on this floor when it established the burden sharing mechanism in 1986. The Articles of Agreement allowed for a looser restriction, setting the floor at 80 percent. In 1990, Dawson (United States) offered to accept the 80 percent floor if the Board would agree to sell or otherwise mobilize a small portion of the IMF's gold stock as an additional way to shore up the Fund's financial protection against a loan default.<sup>18</sup>

Camdessus responded to Dawson's initiative by proposing to create a second SCA aimed at generating an additional SDR 750 million in reserves, with more of the burden shifted to creditor countries. To apply a comparable increase in charges to borrowers, he argued, would raise serious issues of risk. In contrast to the original SCA with its equal burdens, this new "SCA-2" would be funded two-thirds by creditors and one-third by debtors. After some discussion, the Board agreed to this proposal, with the modifications that the SCA-2 should generate SDR 1 billion in reserves and that

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<sup>17</sup>See Boughton (2001), pp. 813–16 and 831–32.

<sup>18</sup>On the 1986 decision, see minutes of EBM/86/122 (July 25, 1986). The initial proposal and discussion of the 85 percent floor was made at an earlier informal Board meeting, at which no minutes were recorded. Dawson's new proposal was also made at an informal session; see minutes of IS/MTG/90/5 (January 31, 1990), p. 9.

creditors should bear 75 percent of the burden, subject to the 80 percent floor on the rate of remuneration.<sup>19</sup>

The Managing Director could have justified this “extended burden sharing” and the establishment of SCA-2 as a necessary and prudent action to cover the risks arising from overall arrears cases. Instead, he proposed it as also necessary to provide “backing” for the RAPs the Fund was preparing to approve. That generated a bit of an uproar. Several Directors from developing countries wanted to know: If a country settled its arrears, successfully completed a period of policy implementation under the Fund’s watchful eye, and then began borrowing anew, why would the Fund need extra backing for these new commitments? The short answer was that the SCA-2 was needed to provide comfort to creditor countries and therefore was a *sine qua non* for their support for the rights approach. In addition, even without the link to the RAPs, it might be needed for the broader purposes of financial prudence.<sup>20</sup> These differing perspectives delayed approval of the SCA-2 for a few months, but it was eventually approved in June 1990.

Over the next seven years, the Fund accumulated the SDR 1 billion in the SCA-2. Overall, the Fund’s precautionary reserves more than doubled, from SDR 1.61 billion in April 1990 to SDR 3.76 billion seven years later. Nearly three-fourths of the increase took the form of transfers to the two SCAs. The rest accrued through the normal retention of net income. At the same time, the settlement of several outstanding arrears cases lowered the outstanding balance that was notionally measured against this reserve from SDR 2.57 billion to SDR 1.86 billion.<sup>21</sup> The IMF had sufficient cover for any potential defaults, and the financial concerns gradually faded away.<sup>22</sup>

The second part of the U.S. initiative—mobilizing gold—took much longer, although the process got under way quickly. In April 1990, Dawson clarified that the United States wanted a commitment by the IMF to use a portion of its gold stock “to backstop resources of the Enhanced Structural Adjustment Facility [ESAF] to finance

<sup>19</sup>Specifically, to fund the new account, “(a) the rate of charge shall be increased by 0.35 percentage point and, subject to the limitation in (b), an amount equivalent to three times the proceeds of that adjustment during an adjustment period shall be generated through reduction in the rate of remuneration during the same period. (b) No adjustment in the rate of remuneration under this paragraph shall be carried to the point where the average remuneration coefficient would be reduced below 80 percent for an adjustment period”; Executive Board Decision No. 9471-(90/98), adopted June 20, 1990.

<sup>20</sup>For Camdessus’s original proposal, see minutes of EBM/90/20 (February 20, 1990), pp. 3–15. For the Board’s detailed discussion of the revised proposal under the rubric of “extended burden sharing,” see minutes of EBM/90/71 (May 2, 1990).

<sup>21</sup>These amounts are the total General Resources Account (GRA) credit outstanding to countries in protracted arrears, including balances not yet due and payable, plus outstanding overdue charges and interest.

<sup>22</sup>As discussed in Chapter 13, p. 669, the SCA-2 was liquidated in 1999, and most countries donated their balances back to the IMF to help fund the enhanced Heavily Indebted Poor Countries Initiative.

purchases under the rights program.”<sup>23</sup> On that understanding, the staff hurriedly prepared a specific proposal, which the Executive Board discussed and approved in principle in early May.<sup>24</sup> The Interim Committee endorsed it in its communiqué the following week:

The Committee concurred with the proposal that the Fund pledge use of up to 3 million ounces of gold, if needed, as additional security for use of the resources of the [ESAF] in connection with the financing of the [RAPs]. It urged that members approve the decisions necessary to establish such a pledge as soon as possible.<sup>25</sup>

The difficulty at that point was that any commitment to sell gold had to be approved with an 85 percent majority before it could be implemented.<sup>26</sup> Although the United States had requested the pledge, the U.S. Executive Director could not vote for it under U.S. law until he was authorized by Congress to do so. The government submitted the necessary legislation, but it worked its way slowly through the system and did not become law until the fall of 1992. Only then could the Executive Board sensibly return to the issue and adopt the proposed decision.<sup>27</sup> The Board finally did so in February 1993, without dissent.<sup>28</sup>

Although the gold pledge remained in place throughout the decade and beyond, it was never activated. Both Sierra Leone and Zambia encashed their rights to draw on the ESAF Trust, but they serviced those debts on time and in full. Hence, the trust suffered no losses, and the Fund had no reason to sell any gold.

The cumulative effect of “special charges” on overdue obligations posed another financial obstacle to the settlement of arrears. One of the Fund’s first acts to control the problem, taken in December 1985, was to raise the interest rate on overdue obligations above the standard rate of charge. The intention was to shift the burden onto the countries with arrears rather than forcing all borrowers to pay higher rates to cover the institution’s costs (Boughton, 2001, pp. 811–12). Over the next five years, through January 1991, the Fund imposed a total of about \$312 million in special charges on

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<sup>23</sup>Minutes of EBM/90/59 (April 16, 1990), p. 17.

<sup>24</sup>The staff presented its proposal at EBM/90/69 (April 30, 1990). The Executive Board discussed it at that meeting and at the next two and agreed on May 2 to send a recommendation to the Interim Committee. The committee communiqué was issued on May 8.

<sup>25</sup>*Annual Report 1990*, p. 113.

<sup>26</sup>Specifically, Article V, Section 12, of the Articles of Agreement permits the IMF to sell gold at market prices, deposit the original purchase value in the GRA, and deposit the excess in the Special Disbursement Account (SDA). Any such sale must be approved by 85 percent of the total voting power in the Executive Board. If the excess proceeds are to be used for any valid purpose other than general operations within the GRA (such as protecting the ESAF Trust), approval of that use also requires an 85 percent majority of the total voting power. Use of the excess proceeds for general GRA operations requires only 70 percent approval.

<sup>27</sup>The text of the 1993 gold pledge to protect the ESAF Trust is available at <http://www.imf.org/external/pubs/ft/history/2011/index.htm>.

<sup>28</sup>Minutes of EBM/93/23 (February 22, 1993). Also see “Modalities of a Gold Pledge for Use of ESAF Trust Resources under the Rights Approach,” EBS/93/10 (January 25, 1993).



38 countries. Of that total, only about \$55 million was collected. The rest was added to the balance in arrears.<sup>29</sup>

Most (89 percent) of the outstanding balance of accrued special charges was owed by four countries: Liberia, Peru, Sudan, and Zambia. Six other countries had smaller absolute amounts outstanding, but the charges were piling up and were becoming a significant factor causing each country's arrears to rise rapidly. With the advent of the rights approach, this accumulation was becoming a potential bottleneck. For a country undertaking a RAP, a donor support group would be expected eventually to help the country settle its arrears so it could encash its rights and normalize its relationships with the Fund and other creditors. If donors had to cover the cost of repaying special charges on top of other arrears, the budgetary consequences could be substantial. Moreover, the burden sharing mechanisms for deferred charges (introduced after the system of special charges) already helped greatly to spread the burden across the whole membership.

In March 1991, the staff proposed suspending the imposition of special charges on any country implementing a RAP. Executive Directors generally liked the idea but thought it failed to go far enough. Tanya Sirivedhin (Alternate, Thailand) suggested abolishing the system of special charges altogether. Several other chairs supported her, but the winning idea came from Dawson, who noted the possibility of suspending special charges "could be used as a strong incentive for countries showing a high level of cooperation."<sup>30</sup> The staff prepared a slightly broader proposal, under which special charges would be suspended for any country currently in protracted arrears, if it was implementing a RAP or other Fund-monitored program or if it was cooperating with the Fund and was making enough payments to keep its arrears from rising.<sup>31</sup>

Of the nine countries with protracted arrears in April 1991, five soon qualified under this broad policy. By April 1992, the Fund had suspended special charges for Panama, Peru, Sierra Leone, Vietnam, and Zambia. The difficulty remained, however, that the most intractable cases were continuing to be aggravated by the accumulation of high interest charges. As it became ever clearer that no one was gaining from this practice, the Fund took advantage of the next annual review of special charges to suspend them altogether for all outstanding cases. To retain their deterrent effect, they

<sup>29</sup>"Six-Monthly Report on Overdue Financial Obligations to the Fund—Progress Under the Strengthened Cooperative Strategy," EBS/91/41 (March 12, 1991). The large number of countries, relative to the smaller number of countries with protracted arrears, reflected the policy of applying special charges as soon as a payment was overdue by 10 business days.

<sup>30</sup>Minutes of EBM/91/42 (March 25, 1991), pp. 5 (Sirivedhin) and 11 (Dawson).

<sup>31</sup>Minutes of EBM/91/63 (April 24, 1991), pp. 49–51. The decision limited the option of suspension of charges only to the nine countries that had protracted arrears as of that date (Cambodia, Liberia, Panama, Peru, Sierra Leone, Somalia, Sudan, Vietnam, and Zambia).



would still apply to any new cases, but for most practical purposes, the role of special charges in the Fund was brought to a close.<sup>32</sup>

## Successful Cases

Of the 11 countries with outstanding overdue obligations to the IMF at the end of the 1980s, 8 cleared their arrears in the course of the next few years. All of these successes resulted in some fashion from the new cooperative strategies and policies the Fund and major donors adopted in the late 1980s and early 1990s. In each case, a combination of strengthened economic policies; improved relations with the international community; policy advice and monitoring from the IMF; and financial support from the Fund, other multilateral agencies, and bilateral donors was essential to resolving the problem.

### Guyana

The first country to benefit from the Fund's new flexibility in the 1990s was the South American republic of Guyana. An IMF member since 1966, Guyana borrowed regularly from the Fund in the late 1970s and early 1980s in response to a weakening international market for sugar, its principal export crop. Low prices persisted for years, and from 1980 on, policy implementation and economic conditions deteriorated badly. That led the Fund to cancel an extended arrangement in 1982 and put further lending on hold. A year later, Guyana fell behind in its repayments, and its arrears accumulated for the next seven years (Figure 16.2).<sup>33</sup>

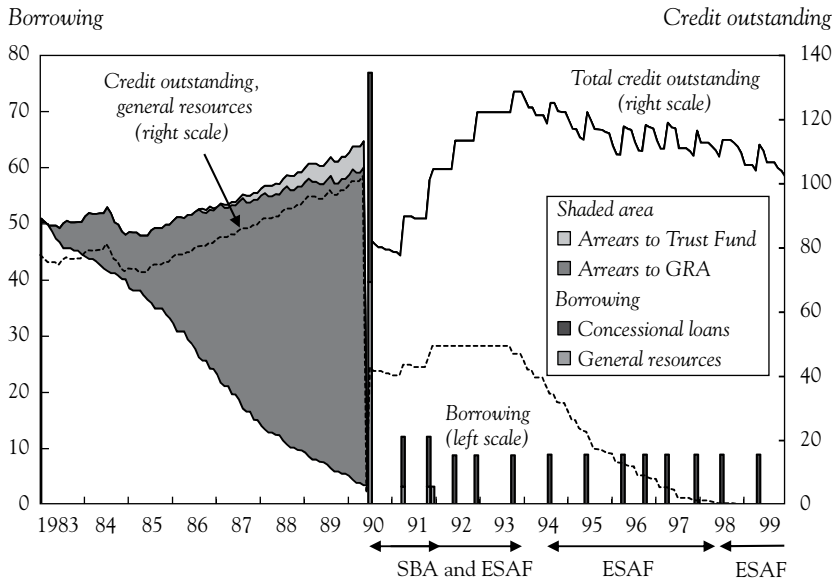
From the middle of 1988 through the first half of 1990, discussions between Guyana and the international community took place on two fronts. In Georgetown, the capital city, a staff team led by Carlos G. Muñiz (Advisor, Western Hemisphere Department) helped the authorities develop a comprehensive program of economic policies aimed at restoring financial viability under realistic assumptions about the future of the sugar market. Although the ultimate success of that program would require external financial support and therefore would require prior settlement of arrears, the intention was simply to establish a credible plan to be implemented more fully once the books were

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<sup>32</sup>Very small amounts continued to accrue for a few countries through the rest of the 1990s. Although the revenues did not even cover the cost of administering the system, some Directors argued in 1999 that it should be retained to send appropriate signals about the Fund's resistance to arrears. A majority favored abolition, but the vote failed to reach the 70 percent threshold required under the Articles; see minutes of EBM/99/49 (April 30, 1999).

<sup>33</sup>These developments are covered in more detail in Boughton (2001), pp. 770–74. As Figure 16.2 indicates, most of Guyana's arrears were owed to the GRA, resulting from a stand-by arrangement in 1976–77, the extended arrangement of 1979–82, and a few drawings on the Compensatory Financing Facility. Guyana also had about SDR 7 million overdue to the Trust Fund, in repayment of concessional loans taken out in 1981. For further information, see Attachment II in "Guyana—Overdue Financial Obligations to the Fund—Further Review Following Declaration of Ineligibility," EBS/90/6 (January 10, 1990).

**Figure 16.2. Guyana: Use of Fund Credit, 1983–99**  
*(In millions of SDRs, monthly data)*



Source: The source for data presented in this and similar figures in this chapter is the IMF's International Financial Statistics (IFS) database. "Total credit outstanding" includes purchases from the General Resources Account (GRA), except for reserve tranche purchases; loans from the Structural Adjustment Facility (SAF); loans from administered accounts, including the Trust Fund and the ESAF Trust; and any overdue obligations, including charges, interest, and fees. That last category includes overdue obligations to the SDR Department. This coverage is broader than "credit and loans outstanding" in IFS, which excludes charges, interest, fees, and all transactions in the SDR Department. Other labels in the figures refer to the facilities through which the loans were made.

Note: ESAF = Enhanced Structural Adjustment Facility; GRA = General Resources Account; SBA = Stand-by arrangement.

cleared. Separately, a group of friendly countries, led by Canada, formed a support group—chaired by Canada's Executive Director in the IMF—to help Guyana clear its arrears once the authorities had made satisfactory initial progress on stabilizing their economic policies.

In April 1989, in the first application of the Fund's new intensified collaborative approach, the Executive Board approved Guyana's program as meeting the standards for financial support in the upper credit tranches. It also agreed to monitor implementation for a year, without making any financial commitment, to give the authorities time to reestablish credibility and restore some semblance of stability to the economy. At the same time, the Board endorsed the intention of the Managing Director to approve new loans to Guyana once the Fund-monitored program was completed.<sup>34</sup>

<sup>34</sup>Minutes of EBM/89/48 (April 28, 1989), pp. 45–47.

Guyana completed the program successfully, and all the remaining elements came together quickly in the second quarter of 1990. The next crucial step was to pull together the money to repay the \$140 million (SDR 107.1 million, or 218 percent of quota) Guyana owed to the IMF. Guyana itself had almost no resources it could afford to use for this purpose. The support group provided grants totaling \$49.3 million, and the Bank for International Settlements and its member central banks provided a 90-day bridge loan of \$178 million to help cover settlement of debts to the Fund and other multilateral lenders.<sup>35</sup> As a token gesture of good faith, Guyana used \$600,000 of its own reserves to complete the repayment. On June 20, 1990, on the same day arrears were cleared, the Fund allowed a drawing of \$53 million (SDR 39.7 million) on a new stand-by arrangement—which Guyana needed to help it repay the bridge loan—and disbursed an ESAF loan of \$50 million (SDR 37.2 million).

For the next several years, Guyana continued to borrow—mostly on concessional terms through the ESAF—while its economy grew rapidly, and the government remained within its means to service these new debts. Beginning in 1998, economic performance slackened once more, but Guyana managed to avoid falling again into arrears.

### **Honduras**

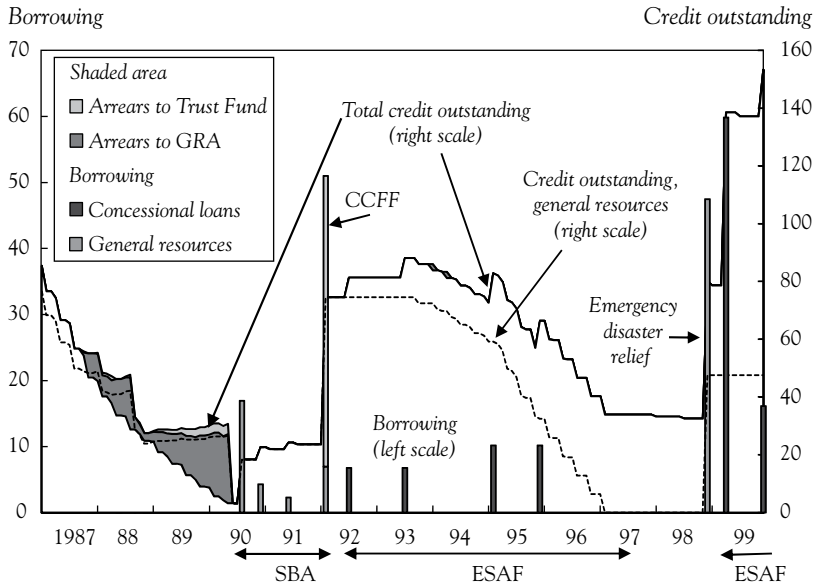
As in Guyana, world prices for Honduras's export crops (coffee and bananas) remained weak throughout much of the 1980s. After 1983, however, Honduras managed to cover its financing needs elsewhere, while gradually repaying its earlier loans from the IMF. From October 1987, those payments to the Fund slowed, and overdue obligations began to accumulate (Figure 16.3). As long as the authorities continued to reduce the total amount outstanding, the Fund was reluctant to take any punitive action, but the situation worsened toward the end of 1988. As the date for presidential elections approached, President José Azcona's government devoted its energies to domestic spending and adopted a populist stance opposing the repayment of foreign debts. With Honduras's external arrears accumulating rapidly and no payments being made, in August 1989 the Fund declared Honduras to be ineligible to borrow (effective November 1).<sup>36</sup> In response, a defiant Azcona reportedly concluded, "What makes me sad is not to have stopped paying the [IMF] three years ago."<sup>37</sup>

The problem did not last long. A new government took office in January 1990 and negotiated a new program with the Fund. On June 28, 1990, after obtaining a bridge loan from a support group led by the U.S. government, Honduras settled all of its

<sup>35</sup>For details of the bridge loan, see BIS Annual Report 1991, pp. 206–07; accessed at [http://www.bis.org/publ/arpdf/archive/ar1991\\_en.pdf](http://www.bis.org/publ/arpdf/archive/ar1991_en.pdf). The loan was designed to help Guyana settle arrears to the IMF, the World Bank, and the Caribbean Development Bank.

<sup>36</sup>For more on Honduras in the 1980s, see Boughton (2001), pp. 802–04.

<sup>37</sup>Reuters News, November 21, 1989, "IMF to Declare Honduras Ineligible for Loans"; accessed at <http://global.factiva.com/>.

**Figure 16.3. Honduras: Use of Fund Credit, 1987–99***(In millions of SDRs, monthly data)*

Source: International Financial Statistics; see Figure 16.2 for further explanation.

Note: CCFF = Compensatory and Contingency Financing Facility; ESAF = Enhanced Structural Adjustment Facility; GRA = General Resources Account; SBA = Stand-by arrangement.

overdue obligations to the Fund (approximately \$36 million, which was less than 4 percent of annual exports). One month later, the Fund approved a 12-month stand-by arrangement for \$41 million (SDR 30.5 million, or 45 percent of quota).

From that point on, Honduras stayed current with the IMF, though it continued to have trouble servicing its other debts to official as well as commercial creditors.<sup>38</sup> The 1990 stand-by arrangement was followed by a sizeable (\$57 million) Compensatory Financing Facility drawing in February 1992 to cover a temporary shortfall in export volumes, and then by an ESAF arrangement that stretched eventually to five years, 1992–97. In response to Hurricane Mitch, which destroyed much of the country's economy and killed thousands of people in October 1998, the Fund provided emergency disaster relief (see Chapter 5) and then approved a larger ESAF arrangement the following March.

<sup>38</sup>On two occasions in 1994, Honduras fell slightly behind in repaying the IMF, but each time it caught up in the following month.

## **Panama**

The most overtly political case of arrears to the IMF in the 1980s was Panama's. In 1987, the U.S. government began investigating the chief of Panama's armed forces (and de facto political ruler), General Manuel Noriega, on a variety of criminal charges. That investigation, which was intensified in April 1988 with the imposition of financial sanctions, severely disrupted the country's economic and financial activity. Panama, unable to access its dollar reserves, could not meet its payments to the Fund, and arrears accumulated rapidly (Figure 16.4). U.S. military forces invaded Panama in December 1989 and arrested Noriega, after which the previously elected president, Guillermo Endara Galimany, was restored to his position.<sup>39</sup>

Panama's international relations normalized fairly rapidly after this upheaval. In 1990, the new government began strengthening its economic policies in the framework of a staff-monitored program, while the U.S. government began organizing a support group of donor countries to help Panama clear its arrears to the Fund and other multilateral institutions. In September, the Executive Board approved the continuation of the economic program as a Fund-monitored (as opposed to staff-monitored) program, meaning satisfactory progress was being made and the program met the standards for Fund support in the upper credit tranches. At that time, the authorities in both Panama and the United States expected arrears to be cleared by the end of the year.<sup>40</sup> However, Panama took much longer to raise the money, and it cleared all of its arrears to the Fund and other official creditors only in February 1992.<sup>41</sup> The Fund then resumed lending and approved both a 22-month stand-by arrangement and a CCF drawing. This lending continued through the rest of the decade.

## **Peru**

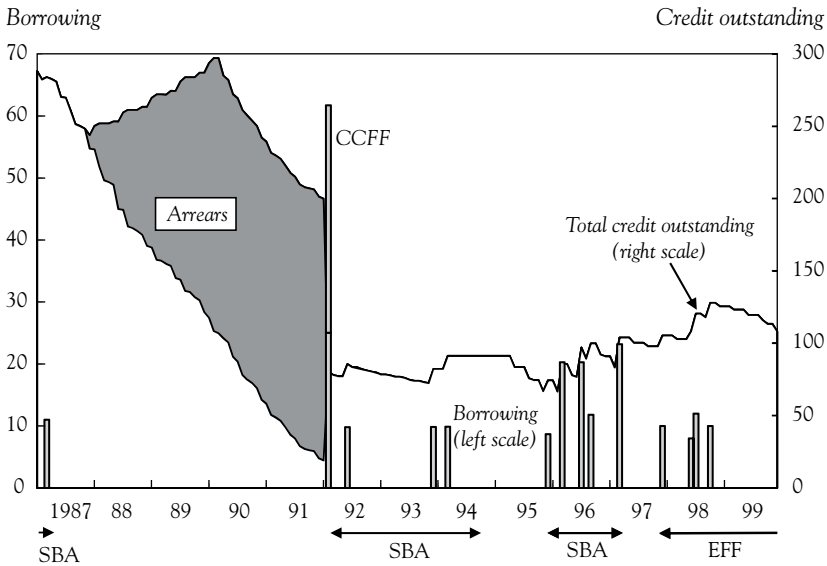
Peru's arrears to the Fund dated from September 1985, when President Alan García unilaterally declared a ceiling on payments on all external debts equivalent to 10 percent of the country's earnings of foreign exchange. Because Peru had the resources to service its debts to the IMF but chose instead to limit its payments, the Fund reacted quickly by issuing a formal declaration in August 1986 that Peru was no longer eligible to use Fund resources.<sup>42</sup>

<sup>39</sup>These developments are covered in Boughton (2001), pp. 799–802.

<sup>40</sup>See minutes of EBM/90/141 (September 12, 1990).

<sup>41</sup>The complication in this case was that some donors insisted that Panama normalize its relations with the World Bank and the Inter-American Development Bank as well as with the IMF before allowing any grants to be released. Eventually, the Fund agreed to establish an administered account to receive donations for Panama and hold them in escrow until they could be used to settle arrears with all three of those institutions plus the International Fund for Agricultural Development; see "Panama—Establishment of an Administered Account," EBS/92/12 (January 23, 1992). The account was established on January 28, and Panama cleared its arrears on February 5.

<sup>42</sup>The onset of Peru's arrears in the 1980s is covered in Boughton (2001), pp. 783–86.

**Figure 16.4. Panama: Use of Fund Credit, 1987–99***(In millions of SDRs, monthly data)*

Source: International Financial Statistics; see Figure 16.2 for further explanation.

Note: CCFF = Compensatory and Contingency Financing Facility; EFF = Extended Fund Facility; SBA = Stand-by arrangement.

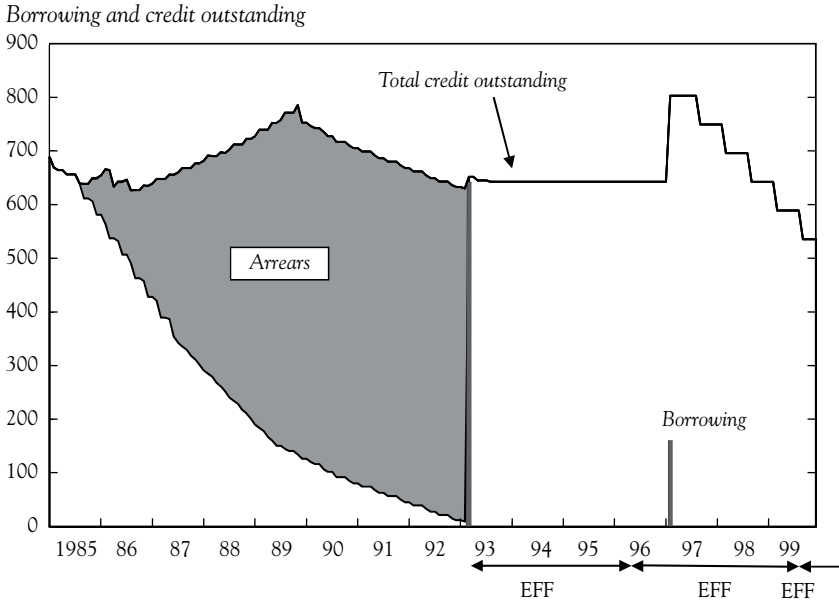
The next three years were a standoff, during which Peru made only modest occasional payments to the Fund, while continuing to repay other creditors more inclined to promise new loans. As arrears accumulated (Figure 16.5), the Fund repeatedly declared Peru to be failing to meet its obligations under the Articles. Toward the end of 1989, however, the first signs of *détente* began to appear. The Fund by then had initiated its intensified collaborative approach to dealing with arrears cases. In Peru, the next presidential election—effectively a referendum on García’s policies—was rapidly approaching. Both sides thus had reason to show new flexibility.

In December 1989, Peru made a payment of some \$43 million (SDR 32.8 million), which reduced its overdue obligations to the level outstanding at the end of August. The authorities also signaled they would now make regular payments to cover all amounts coming due. In other words, arrears would be held constant, and total outstanding obligations would gradually decline. In addition, they agreed to receive an IMF staff mission to hold Article IV consultation discussions and help them design a multiyear economic policy program.<sup>43</sup>

The Fund responded positively to these modest but politically significant gestures by taking two similarly modest but significant actions. First, it postponed further

<sup>43</sup>“Peru—Overdue Financial Obligations to the Fund—Further Review Following Declaration of Ineligibility,” EBS/90/30 (February 21, 1990), p. 2.

**Figure 16.5. Peru: Use of Fund Credit, 1985–99**  
*(In millions of SDRs, monthly data)*



Source: International Financial Statistics; see Figure 16.2 for further explanation.  
 Note: EFF = Extended Fund Facility.

consideration of issuing a declaration of noncooperation. Second, it agreed to provide technical assistance the government had requested to help it stabilize its finances.<sup>44</sup>

In June 1990, voters elected Alberto Fujimori to succeed García as president of Peru. As part of a broad effort to stabilize the economy and resume economic growth, Fujimori set out to continue and accelerate the move, initiated by his predecessor, to normalize creditor relations. The international community responded enthusiastically. Japan and the United States convened a broad support group of donors that included nine European countries and Canada. Separately, four Latin American countries—Chile, Colombia, Mexico, and Venezuela—offered short-term bridging loans.<sup>45</sup> Once those pledges were in place, the IMF and other multilateral institutions arranged for Peru to settle its arrears and obtain new financing.

<sup>44</sup>The Managing Director had scheduled a meeting of the Executive Board for February 23, 1990, to consider issuing a declaration that Peru was failing to cooperate with the Fund in finding a means to clear its arrears. The government sent three senior officials, led by its chief debt negotiator, Abel Salinas, to participate in the Board meeting as an expression of conciliation; minutes of EBM/90/25 (February 23, 1990), pp. 11–28.

<sup>45</sup>These pledges are summarized in a statement by Dawson (United States) at EBM/91/121 (September 12, 1991), p. 41. For Peru’s simultaneous efforts to settle arrears and reschedule debts with commercial creditors, see Chapter 9.

In March 1991, the Fund expressed its approval of the Fujimori government's policies and declared they "could serve as the basis for a two-year Fund-monitored rights accumulation program for Peru, provided that the necessary financing assurances would be available."<sup>46</sup> The reference to "financing assurances" meant that the support group would have to make its commitments first, and then the Fund would formally approve the onset of rights accumulation. That step was completed in September, and Peru became the second country (after Zambia; see below) to embark on a RAP.

Peru offers a clear picture of the way in which the RAP served to mobilize both policy reforms and international donor support and culminate in an effective rescheduling of outstanding obligations. When the Executive Board approved the arrangement, Peru had outstanding arrears totaling about \$840 million (SDR 623 million). The two-year arrangement called for the Fund to make a conditional commitment to lend up to that amount to Peru. The actual disbursement would be made through a successor Extended Fund Facility arrangement commencing after the successful completion of the two-year program, but it would be heavily front-loaded so the initial disbursement would be roughly equivalent to the outstanding arrears. Meanwhile, the support group and possibly other donors would help finance the program throughout the period the RAP was in effect, and Peru would be expected to avoid any further accumulation of arrears.

In Peru's case, the plan worked as expected, despite setbacks in donor support owing to concerns about political stability and the government's worsening record on human rights.<sup>47</sup> Peru completed the RAP in March 1993, by which time it had accumulated the full amount of the Fund's commitment. At that time, Japan and the United States advanced bridge loans so Peru could settle its arrears. Immediately afterward, the Executive Board approved a three-year Extended Fund Facility arrangement totaling \$1.4 billion (SDR 1,018.1 million, or 218 percent of Peru's quota). Almost \$890 million (SDR 642.7 million) was disbursed right away, so Peru's outstanding indebtedness was nearly constant (see Figure 16.5) but was made current with a new seven- to ten-year repayment schedule. The combination of strong economic policies and new official and commercial financing enabled Peru to forgo any further drawing on the Fund arrangement through 1996.<sup>48</sup>

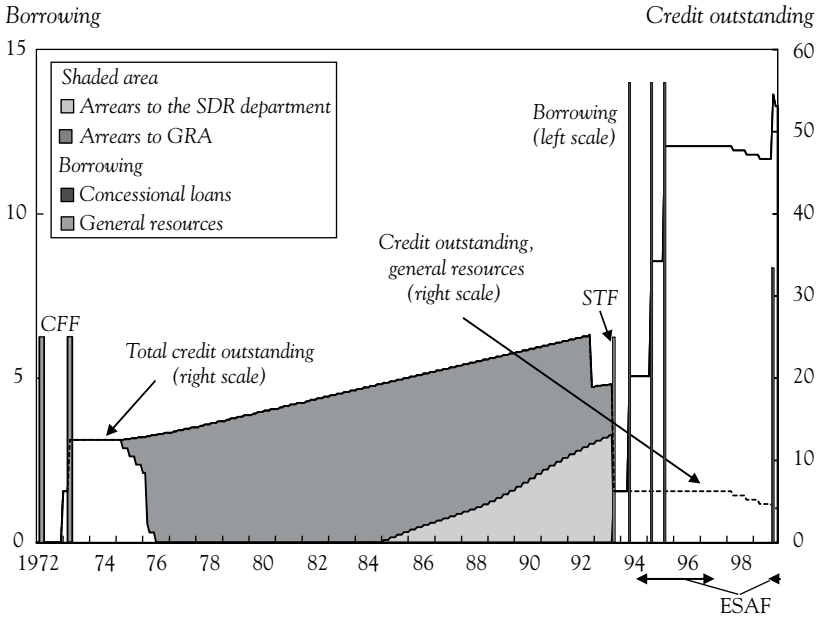
<sup>46</sup>Decision No. 9678-(91/38); minutes of EBM/91/38 (March 15, 1991), p. 36.

<sup>47</sup>In April 1992, international condemnation was widespread after Fujimori dissolved the Congress in what became known as the *autogolpe* (auto-coup). New elections were held in November, but a further delay in the arrangement with the IMF resulted when the new U.S. administration under President Bill Clinton raised objections to human rights abuses in Peru.

<sup>48</sup>After making one last drawing on a new extended arrangement in 1997, Peru had no further recourse to loans from the IMF during the next decade. It completed the timely repayment of these loans in 2007.



**Figure 16.6. Cambodia: Use of Fund Credit, 1972–99**  
*(In millions of SDRs, monthly data)*



Source: International Financial Statistics; see Figure 16.2 for further explanation.  
 Note: CFF = Compensatory Financing Facility; ESAF = Enhanced Structural Adjustment Facility; GRA = General Resources Account; STF = Systemic Transformation Facility.

### Cambodia

At the start of the 1990s, Cambodia had been in arrears on its payments to the IMF far longer than any other member country—ever since the Khmer Rouge temporarily took control of the country in April 1975 (Figure 16.6). Throughout the horrors and upheavals of the next 15 years, including 10 years of Vietnamese occupation, Cambodia lacked an internationally recognized government, and the IMF lacked any channel for official communication with the member.

The withdrawal of Vietnamese forces in 1989 did not immediately open an acceptable line of communication, but it did create an opportunity for incremental progress. The government-in-exile, then based in Thailand, was led by Prince Norodom Sihanouk, the former king who had ruled Cambodia for nearly three decades from 1941 to 1970. At this time, Sihanouk was receiving some support from the United States and was widely seen as the best hope for a return to normalcy. In June 1991, Sihanouk wrote to Camdessus to request the “readmission” of Cambodia into the IMF “as soon as possible.” Camdessus welcomed the initiative, but he responded noncommittally: “We are watching events in your country with great interest, and welcome the significant progress being made towards peace. We look forward to the emergence of a

representative, national government and the normalization of relations with the Fund.”<sup>49</sup>

The critical event enabling this normalization was the signing of a comprehensive peace treaty by all of the involved parties in Paris in October 1991, after which Sihanouk returned to Cambodia as head of state. Beginning in November, the United Nations (UN) and the Asian Development Bank organized a series of missions to Phnom Penh, in which Fund staff participated, to gather information about economic and political developments and offer technical assistance. Through this time, however, the Fund remained wary of dealing with a government that might not have the ability to control the economy.

The political balance in Cambodia in 1992 was delicately poised. The nominal government in Cambodia was still led by Hun Sen, who had been placed in office during the Vietnamese occupation. This government was not accepted internationally as legitimate, and under the terms of the Paris peace treaty it was under the control of the UN. The Supreme National Council (SNC), led by Sihanouk but also including representatives of the Khmer Rouge, was recognized but had no administrative control over the country. The SNC had authorized the Hun Sen government to act on its behalf as its “executive arm.” It was with this fragile structure that the international community was trying to work. Only after the IMF received written assurances on the viability of the government’s structure from the SNC and the UN Transitional Authority in Cambodia did the Fund agree to reestablish formal communications and take steps toward normalization and the settlement of arrears. That development occurred in October 1992.<sup>50</sup>

After several fact-finding missions and the formal decision to normalize relations, a Fund team led by John R. Dodsworth (Division Chief, Central Asia Department) negotiated a reform and stabilization program to be monitored informally by the staff through 1993.<sup>51</sup> That opened a pathway for the clearance of arrears. As the first step on that path, the IMF undertook a unique set of transactions made possible by the peculiar features of the long interlude in relations from 1975 to 1992. In the late 1970s, the Fund had restituted 25 million ounces of gold to its member countries and had sold another 25 million ounces at market prices to finance the original Trust Fund for lending to low-income countries on concessional terms. Because of the absence of a line of communication, the Fund had held Cambodia’s share of the proceeds on the member’s behalf, pending settlement of arrears. Now, in December 1992, the Fund and Cambodia agreed the Fund would reconstitute the gold to the country, simultaneously buy it back at the current market price, and apply the proceeds to the outstanding arrears.

<sup>49</sup>“Cambodia—Relations with the Fund,” EBD/91/235 (July 31, 1991); official translation from the original French.

<sup>50</sup>“Statement by the Staff Representative on Cambodia,” EBD/92/213 (September 17, 1992); and minutes of EBM/92/127 (October 21, 1992), p. 9.

<sup>51</sup>“Cambodia—Overdue Financial Obligations to the Fund—Review of Decisions to Limit Use of the Fund’s General Resources and Suspend Use of SDRs,” EBS/92/188 (November 24, 1992).

In addition, the profits from the earlier gold sales would be applied to the partial settlement. Together, those transactions reduced Cambodia's overdue obligations to \$43 million from \$52 million (to SDR 31.0 million from SDR 37.3 million).<sup>52</sup>

To cover the rest of Cambodia's arrears settlement, France and Japan assembled a support group of six countries willing to offer grants for this purpose. Once those grants were in hand and Cambodia had made sufficient progress in establishing control over its own finances, the authorities settled their arrears in total on October 1, 1993. Three days later, the Fund lifted the restrictions on Cambodia's use of its resources and approved a \$9 million (SDR 6.25 million) drawing under the terms of the STF. Subsequent drawings, as discussed in Chapter 12, were all on concessional terms, through the ESAF Trust.

### **Vietnam**

Politics also played a major role in the rise and fall of Vietnam's payments arrears to the IMF. The problem began in 1984, when the authorities grew frustrated with the Fund's refusal to agree to provide new loans through a stand-by arrangement. Repayments were coming due on earlier loans the IMF had made from the Trust Fund and the General Resources Account (GRA). The authorities were anxious to reschedule those debts, but the Fund was unimpressed by their proposed economic policies. In addition, Vietnam's occupation of Cambodia, in effect since 1978, was not conducive to good relations with the international community. Although Vietnam had sufficient gold reserves to continue servicing its obligations to the Fund, beginning in April 1984 the authorities decided it was no longer worthwhile to do so.<sup>53</sup>

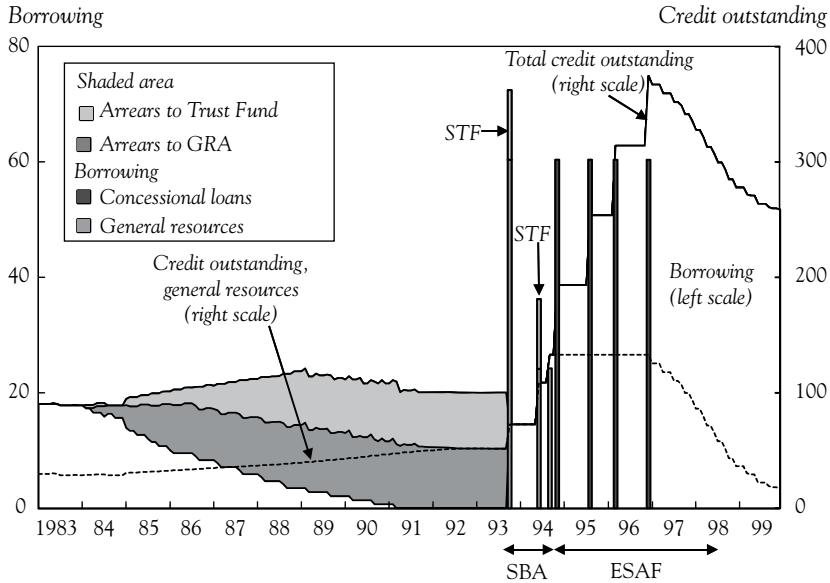
In the second half of the 1980s, Vietnam began to strengthen its economic policies, with remarkable success. As the Fund staff noted in 1991, this success was "all the more remarkable since it [was] achieved without the financial support from industrial countries and international organizations, in the face of the existence of [trade] embargoes, and despite the loss of substantial aid from" the rapidly disintegrating Soviet Union.<sup>54</sup> Indeed, cooperation with the Fund and the international community remained patchy. The authorities made occasional partial payments to the IMF, but arrears continued to

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<sup>52</sup>These figures, and the data plotted in Figure 16.6, exclude SDR 6.24 million outstanding from a gold tranche purchase in September 1971 that was technically overdue but was not part of Fund credit outstanding. Before the Second Amendment to the Articles took effect in April 1978, members were obligated to repurchase such drawings on an agreed-on schedule if they had the means to do so. In 1975, the Fund established a schedule calling for the repurchase to be completed by August 1976, but by that time the Fund and Cambodia were no longer in communication. Under the Second Amendment, the gold tranche was renamed the reserve tranche, and the repurchase obligation was eliminated. As part of a general settlement of arrears, Cambodia could have repaid the gold tranche drawing and immediately taken out a reserve tranche drawing in the same amount.

<sup>53</sup>For more on these developments, see Boughton (2001), pp. 766–70.

<sup>54</sup>"Viet Nam—Staff Report for the 1991 Article IV Consultation," SM/91/225 (November 25, 1991), p. 19. For a detailed assessment of the economic progress, see Dodsworth and others (1996).

**Figure 16.7. Vietnam: Use of Fund Credit, 1983–99***(In millions of SDRs, monthly data)*

Source: International Financial Statistics; see Figure 16.2 for further explanation.

Note: ESAF = Enhanced Structural Adjustment Facility; GRA = General Resources Account; SBA = Stand-by arrangement; STF = Systemic Transformation Facility.

accumulate (Figure 16.7). Despite the withdrawal of Vietnamese forces from Cambodia in 1989, the United States persisted with the trade embargo it had imposed during the war that had ended in 1975. By this time, the U.S. goal—driven by domestic politics—was primarily to force cooperation on efforts to identify the remains of missing U.S. personnel and to ensure Vietnam no longer held any prisoners of war. Other major countries, notably France and Japan, took a more positive view of economic and political developments in Vietnam, but U.S. opposition was strong enough to block a settlement.

When the Executive Board met in December 1991 to conclude the Article IV consultation with Vietnam for that year, most Directors were eager to resolve the impasse.

The French and Japanese governments had assembled a group of donors prepared to finance the settlement of Vietnam's arrears, and almost everyone agreed the country's economic progress deserved international support. No one was prepared to move, however, until U.S. opposition softened.<sup>55</sup> At the Board meeting, while other Directors expressed at least lukewarm support, Quincy M. Crosby (Alternate, United States)

<sup>55</sup>Miyashita (2003), Chapter 5, provides a thorough analysis of the influence of U.S. pressure on Japan in delaying the restoration of diplomatic relations with and financial support for Vietnam.

complained about Vietnam's "misplaced ambivalence about the virtues of market mechanisms and a lingering attachment to centralized control." E.A. (Ted) Evans (Australia) showed his exasperation with that view by calling it "poorly informed." In his view, Vietnam's difficulties resulted "not because of a lack of effort on the part of the Vietnamese authorities, but because of the decision of the international community not to provide the financing that would allow Vietnam to adopt a comprehensive program." In the end, Camdessus observed that there was "very broad—though not as yet unanimous—support to move forward in the normalization of Vietnam's international financial relations," and he promised the Vietnamese and the Board they could "count on my personal effort to this end."<sup>56</sup>

The change of U.S. administration that occurred in January 1993 allowed relations to improve. The Vietnamese government responded with a more welcoming attitude toward American efforts to find and identify the remains of missing personnel. Before the year was out, on October 5, 1993, Vietnam settled all of its arrears, and the IMF prepared to resume lending.<sup>57</sup>

Vietnam's arrears—to the GRA, the Trust Fund, and the SDR Department—totaled about \$142 million (SDR 100.2 million). The nine countries in the support group provided grants totaling \$55 million, and the rest was made possible by a bridge loan syndicated by agencies in France and Japan. On October 6, the IMF disbursed a \$17 million (SDR 12.1 million) loan through the Systemic Transformation Facility (STF) and an \$85 million initial drawing on a new stand-by arrangement. Those sums enabled Vietnam to repay the bridge loan.

The nearly simultaneous settlement of long-standing overdue obligations by both Cambodia and Vietnam in the first week of October 1993 signaled major progress in fulfillment of the IMF's commitment to resolve the arrears crisis of the 1980s. To mark the occasion, Camdessus made his first-ever trip to the region, with stops in Phnom Penh, Hanoi, and Ho Chi Minh City. Both in private meetings with senior political leaders and in public forums, he hailed these developments not only for marking the normalization of international relations for the two neighboring countries but also for potentially enabling the beginning of a new era of prosperity.

For the next year, the Fund lent to Vietnam through the stand-by arrangement and a second STF loan. Lending then switched to the less costly ESAF. Total indebtedness peaked at the end of 1996, after which Vietnam was able to obtain sufficient financial assistance from Japan and other development aid sources and gradually repay the Fund.

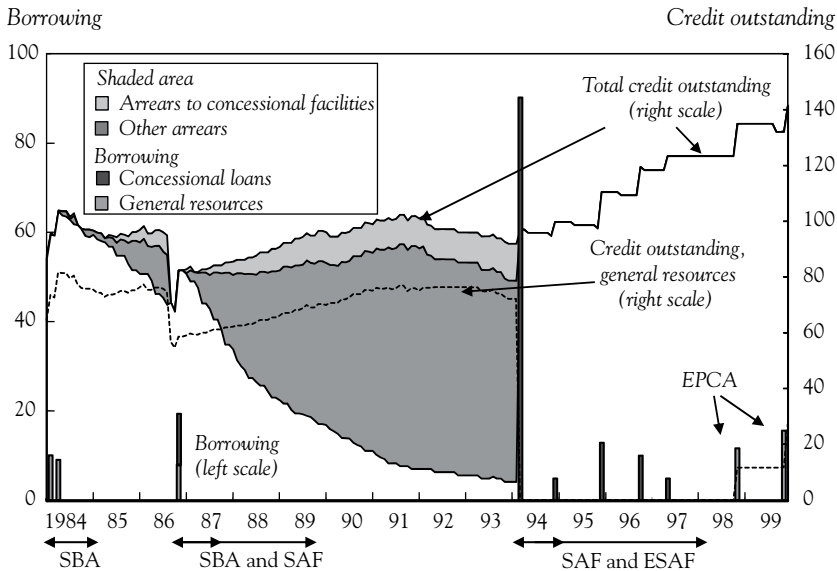
### **Sierra Leone**

Throughout much of the 1980s, Sierra Leone struggled to implement sound economic policies and stay current on its external debts. Those efforts faltered,

<sup>56</sup>Minutes of EBM/91/170 (December 18, 1991), pp. 15 (Krosby), 22 (Evans), and 29 (Camdessus).

<sup>57</sup>The United States ended its trade embargo against Vietnam in February 1994. Formal diplomatic relations were established in July 1995.

**Figure 16.8. Sierra Leone: Use of Fund Credit, 1984–99**  
(In millions of SDRs, monthly data)



Source: International Financial Statistics; see Figure 16.2 for further explanation.

Note: EPCA = Emergency Postconflict Assistance; ESAF = Enhanced Structural Adjustment Facility; SAF = Structural Adjustment Facility; SBA = Stand-by arrangement.

however, and arrears continued to accumulate; the IMF declared the country ineligible for further borrowing in April 1988.<sup>58</sup> In the second half of 1989, Sierra Leone resumed making small payments, though not enough to keep arrears from rising (Figure 16.8). The authorities also entered into discussions with Fund staff with the aim of further strengthening policies. Although a few creditor countries, especially the United States, were skeptical of these moves, the Executive Board adopted a relatively relaxed posture aimed at encouraging the reformers within the government.<sup>59</sup>

The staff and the authorities met frequently in 1990 and 1991 to develop a program for the Fund to endorse and for donor countries to support. That effort culminated on April 3, 1992, when the Executive Board approved Sierra Leone as the third country (after Zambia and Peru) to have a RAP. The World Bank organized an informal support group of donor countries to coordinate financial assistance while Sierra Leone tried to carry out the Fund-monitored program. Unfortunately, during this same period

<sup>58</sup>See Boughton (2001), pp. 792–95.

<sup>59</sup>See in particular the minutes of EBM/90/51 (April 2, 1990), where Directors reluctantly accepted a U.S. proposal to add language to its conclusions noting that the Fund “regrets the recent policy slippages,” but declined to accept other amendments that would have threatened further punitive actions.

the country was descending into a social and political abyss. A rebel group based in neighboring Liberia began an armed insurrection in March 1991, gradually taking control of more and more territory. As the government's grip on power started to slip, a military coup overthrew the government in April 1992, just weeks after the IMF's approval of the RAP.

The military government, constituted as the National Provisional Ruling Council, continued the civilian government's policy of cooperating with the Fund and implementing the RAP. Despite the ongoing insurrection—linked to the Liberian outlaw, Charles Taylor, and employing increasingly brutal acts of terrorism—the authorities successfully completed the program in less than two years. With help from bridge loans provided by France, Norway, and the United States, Sierra Leone settled its arrears on March 28, 1994.

The \$120 million Sierra Leone repaid in 1994 was mostly the principal and interest on stand-by arrangements from the 1980s, plus a relatively small amount from a 1986 Structural Adjustment Facility (SAF) loan. The imperative now was to switch to loans on concessional terms that would be less likely to drive the country back into an unsustainable debt burden. On the same day that Sierra Leone repaid its old loans, the Executive Board approved new loans through the SAF (\$38 million available immediately) and the ESAF (\$125 million, of which \$89 million was available immediately).

Much of the initial disbursement of these heavily front-loaded arrangements was used to repay the bridge loans. As is evident in Figure 16.8, this series of actions left Sierra Leone's indebtedness virtually unchanged. The benefits were to reschedule the debt into a lower-cost and longer-maturity form, to put economic policies on a sustainable and positive path, and to establish the preconditions for a resumption of donor support.

For the rest of the 1990s, relations between Sierra Leone and the IMF proceeded smoothly, notwithstanding the horrors of the ongoing insurrection with which a series of governments had to cope.<sup>60</sup> The policies the Fund supported with a four-year ESAF arrangement were carried out successfully. In November 1998, as the insurrection finally was being brought under control, the Fund began providing emergency post-conflict assistance from its general resources. Those loans were repaid on schedule, and the Fund continued to assist the country through the Poverty Reduction and Growth Facility (the ESAF successor) in the following decade.

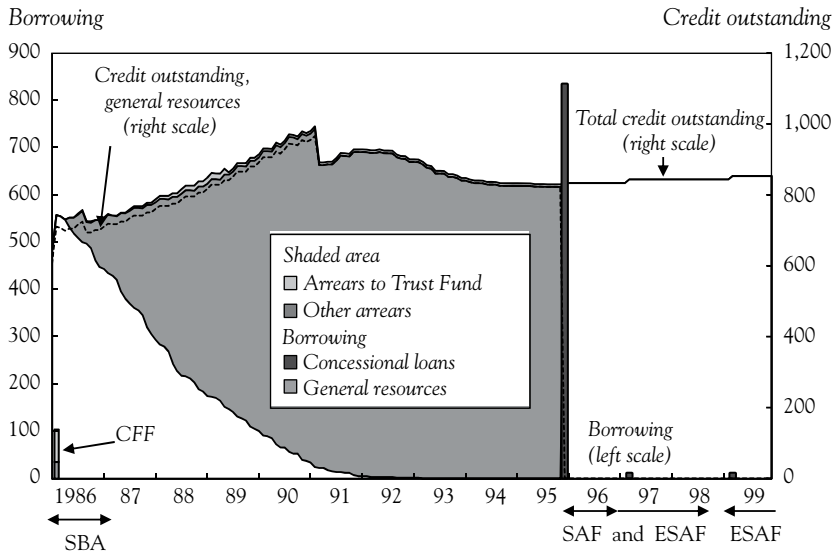
## **Zambia**

The first country to be approved for a RAP, but the third and final one to complete the program in the 1990s, was Zambia. A collapse in the world copper market in

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<sup>60</sup>The first multiparty elections were held in 1996. That government was overthrown in 1997, and a military junta ruled for some 10 months until a multilateral force led by Nigerian troops reinstated the elected officials. The 1997 coup led to attacks on the IMF's Resident Representative and his family, who had to be rescued and evacuated; see Chapter 17, p. 894.

**Figure 16.9. Zambia: Use of Fund Credit, 1986–99**  
(In millions of SDRs, monthly data)



Source: International Financial Statistics; see Figure 16.2 for further explanation.

Note: CFF = Compensatory Financing Facility; ESAF = Enhanced Structural Adjustment Facility; SAF = Structural Adjustment Facility; SBA = Stand-by arrangement.

the 1980s hit this copper-exporting country hard, and the government tried but ultimately failed to put in place a program of sustainable economic policies. As payments arrears accumulated, the Fund reluctantly but unavoidably declared Zambia ineligible for further borrowing in September 1987.<sup>61</sup>

After the declaration of ineligibility, Zambia shifted to more stringent policies, but decided initially to rely heavily on trade and exchange restrictions to strengthen the balance of payments. By late 1988, these controls were leading to widespread smuggling and other underground activity. Inflation rose sharply, as did the fiscal deficit. Zambia's long-serving president, Kenneth Kaunda, then shifted gears again, aiming to promote stability and growth through more conventional means even if it meant taking draconian measures with major social consequences. In the first half of 1989, he tripled the price of maize (a diet staple that was in short domestic supply), introduced rationing coupons, cut the foreign exchange value of the currency in half, and lifted price controls on a wide range of consumer goods. The government negotiated a Policy Framework Paper with the Fund and the World Bank, which the institutions approved in September 1989 as a basis for new lending on concessional terms once arrears were

<sup>61</sup>These developments, through 1987, are covered in Boughton (2001), pp. 787–91.



cleared.<sup>62</sup> In the meantime, however, Zambia's arrears were continuing to pile up (Figure 16.9).

By the beginning of 1990, the staff (led by K. Burke Dillon, Assistant Director, African Department) and the authorities agreed on all of the policy elements for a Fund-monitored program. Potential donor countries formed a Consultative Group, and the Paris Club agreed to consider rescheduling some bilateral debts. Despite the continuation of arrears, the IMF resumed providing technical assistance, and it reopened the Resident Representative office in Lusaka, which had been vacant since 1987. In the absence of new external finance, however, domestic opposition to Kaunda's policy initiatives began to swell. Deadly riots broke out in June 1990, sparked mainly by the sharp increases in food prices.

Progress continued, but in fits and starts. Almost immediately after the Executive Board approved the operational terms of the rights approach, it agreed in principle to accept Zambia as the first country to qualify for a RAP. The policy framework was already in place, and the formation of the Consultative Group gave some assurance that the program could be adequately financed without an injection of cash from the IMF. Formal approval of the RAP, however, was delayed until April 1991, shortly after Zambia cleared its arrears with the World Bank. That settlement made Zambia eligible for financial assistance both from donors and from the World Bank's Special Program of Assistance for Africa. That financing assurance made it possible, in turn, for the Fund to make its own forward commitment through the RAP.<sup>63</sup>

As the economy continued to weaken under the weight of a severe drought that decimated maize output, domestic unrest continued to build against the government. In response, Kaunda—Zambia's only president since independence in 1964—decided to restore multiparty democracy and open discussions that would produce a new constitution. Unfortunately for him, he and his party lost the elections, and a new government under Frederick Chiluba took office in November 1991. In the meantime, policy implementation slipped badly during the election season, and Zambia's payments to the Fund fell short of the targets required under the RAP. In October 1991—four weeks before the elections—the Executive Board expressed its “deep regrets” and disappointment at the slippages and declined to approve any accumulation of rights.<sup>64</sup>

Once Chiluba was in office and had put new policies in place, the authorities and the IMF agreed to scrap the original RAP and replace it with a new program that would run through 1995. From that point on, progress was steadier and more evident, though still slow. The Fund granted a number of waivers in 1993 and 1994 and extended the time limit on several occasions in 1995 to keep the program alive and allow Zambia to

<sup>62</sup>See “Zambia—Staff Report on Economic and Financial Program for 1990,” EBS/90/21 (February 13, 1990).

<sup>63</sup>See “Zambia—Staff Report for the 1991 Article IV Consultation and Request for Accumulation of Rights,” EBS/91/59 (April 3, 1991); minutes of EBM/91/55 and EBM/91/56 (April 17, 1991); and PR/91/20 (April 17, 1991).

<sup>64</sup>Minutes of EBM/91/137 (October 2, 1991).

keep accumulating rights. Finally, in December 1995, all elements came together and Zambia successfully completed the program.

On December 6, 1995, the Executive Board made several decisions that helped normalize relations. It took note of Zambia's repayment of all overdue obligations, totaling more than \$1.2 billion (SDR 830.2 million), which had been temporarily financed by single-day bridge loans from 11 donor countries. It lifted the ban on new loans to Zambia. It approved a one-year SAF arrangement and a three-year ESAF arrangement, and it approved immediate disbursement of almost all of that commitment as a way of encashing the rights Zambia had accumulated since 1992. At the end of the day, Zambia had no remaining obligations to the Fund's general resources,<sup>65</sup> it was able to repay all of the bridge loans, and its new loans from the Fund (totaling SDR 833.4 million) were all on concessional terms and would not fall due for several more years.<sup>66</sup>

These large up-front transactions—the largest single use of the IMF's concessional resources in the 1990s—made some donors to the ESAF Trust nervous. At the Board meeting to complete the RAP, Hachiro Mesaki (Japan) worried about Zambia's "unsatisfactory track record" and the consequent "extremely high" risk being shouldered by the creditors of the ESAF Trust. The Fund had pledged the use of up to 3 million ounces of gold (worth about \$400 million at then-current prices) to cover that risk, but Mesaki found it "questionable whether 3 million ounces is sufficient to cover the increased risk." A few other creditors supported him, but the Board as a whole was willing to set those concerns aside, give Zambia the benefit of the doubt, and declare the strengthened arrears strategy to be a success.<sup>67</sup>

### Setbacks: Unresolved Cases from the 1980s

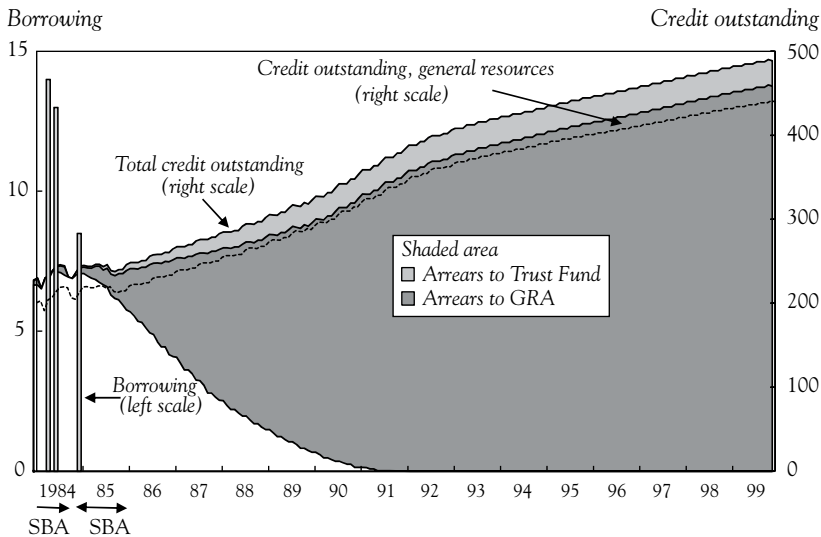
Although most of the countries with outstanding arrears at the onset of the 1990s cleared them within a few years, three major cases proved to be much more difficult. All three—Liberia, Somalia, and Sudan—resumed making some payments, but arrears continued to accumulate. In each case, political instability and a breakdown of civil order underlay the country's economic and financial shortcomings.

<sup>65</sup>On December 6, for technical reasons, the Fund allowed Zambia to make an outright purchase from the GRA. That purchase was repaid as soon as an equivalent disbursement was made on the ESAF arrangement.

<sup>66</sup>The reason for including the SAF instead of making all of the new loans through the ESAF was that the SAF still had a balance of SDR 181.75 million available to lend. That full amount was lent to Zambia, and the facility was then terminated. For more details, see Chapter 13.

<sup>67</sup>Minutes of EBM/95/114 (December 4, 1995). Mesaki's statement is on pp. 26–28. Zambia continued to draw on ESAF and Poverty Reduction and Growth Facility resources over the next decade and more, but it did not again go into arrears.

**Figure 16.10. Liberia: Use of Fund Credit, 1984–99**  
(In millions of SDRs, monthly data)



Source: International Financial Statistics; see Figure 16.2 for further explanation.  
Note: GRA = General Resources Account; SBA = Stand-by arrangement.

### Liberia

The IMF lent heavily to Liberia in 1980–84, as the United States and other major creditors eagerly supported the government’s attempts to recover from the social and economic instability of the previous decade. Disillusionment set in on all sides at the end of that period. Liberia stopped paying the Fund right after the Executive Board approved a new stand-by arrangement; the United States canceled a planned grant to the government; and the Fund stopped disbursing on the arrangement.<sup>68</sup> For the next several years, until 1990, Liberia made a number of small payments, but far less than the amounts coming due. By 1990, almost all of Liberia’s debt to the Fund was overdue (Figure 16.10), and prospects for servicing it were being threatened by a civil conflict that would continue throughout the rest of the decade and beyond.

An insurrection against the Liberian government began in December 1989, led by Charles Taylor, a vagabond warrior who was a fugitive from U.S. justice and was under Libyan patronage. Taylor’s forces quickly took control of most of the country except for the capital, Monrovia. While this assault was under way, an IMF mission tried to carry on discussions as usual in Monrovia. The result bordered on the surreal, as the staff

<sup>68</sup>The deterioration that led the Fund to declare Liberia ineligible to borrow is covered in Boughton (2001), pp. 774–77.

reported to headquarters that “ongoing rebel activity in the north of the country . . . had reportedly distracted senior officials from focusing on economic policy matters.” The staff also complained that the government had just purchased a jet airplane it could ill afford, and it was negotiating to settle arrears with the African Development Bank while making only token payments to the Fund. For those and other reasons, the staff concluded, “Liberia cannot be considered as actively cooperating with the Fund toward resolving the problem of its arrears to the Fund.”<sup>69</sup>

From the Fund’s perspective, the salient point was not that the authorities were unable to act in the middle of a political and military crisis, but rather that they had failed to act responsibly for more than five years. The March 1990 review was the tenth consecutive semiannual review of Liberia’s arrears, and the Executive Board had little patience left. At the Board meeting, the decision to issue the Fund’s first-ever “declaration of noncooperation” was a foregone conclusion. The only real controversy was its wording. The staff proposed stressing that the declaration was but one stage in an escalating series of measures the Fund might take. Specifically, the final paragraph of the draft decision noted that the Board would hold another review by the end of August 1990. “In the event that Liberia has not resumed active cooperation with the Fund . . . , the Fund will give consideration at that time to the initiation of procedures leading to the compulsory withdrawal of Liberia from the Fund.”<sup>70</sup>

A few Directors were squeamish about making this threat in a public declaration. As a message to the authorities, its purpose was clear enough. Whether the threat should be made public was another matter. On that reasoning, Markus Fogelholm (Finland) proposed deleting from the public declaration any reference to compulsory withdrawal. Ultimately, however, a majority of the Board preferred to adhere to the staff proposal.<sup>71</sup>

Before the Fund could conduct a further review and initiate procedures leading to expulsion, the security situation in Liberia worsened dramatically. Taylor’s rebel forces soon reached Monrovia, at which point they captured, tortured, and assassinated President Samuel Doe. A breakaway rebel faction then challenged Taylor, and the two forces settled into a devastating civil war that left Liberia in anarchy for several years. In those circumstances, the Fund had no choice but to put consideration of further

<sup>69</sup>“Liberia—Overdue Financial Obligations to the Fund—Further Review Following Declaration of Ineligibility,” EBS/90/51 (March 19, 1990), pp. 7, 8, and 11.

<sup>70</sup>“Liberia—Overdue Financial Obligations to the Fund—Further Review Following Declaration of Ineligibility,” EBS/90/51 (March 19, 1990), p. 13.

<sup>71</sup>Minutes of EBM/90/49 and EBM/90/50 (March 30, 1990).

measures on hold until a government could be formed and establish relations with the international community.<sup>72</sup>

### **Sudan**

Sudan fell behind in its repayments to the IMF in 1984, continued to pile up overdue obligations for another decade, and stayed in arrears for more than a quarter-century. The origins of the problem, as detailed in Boughton (2001, pp. 777–83), were economic, but the perpetuation was political. Throughout much of the 1970s, Sudan enjoyed ready access to loans from major international banks eager to help finance cotton exports and the exploitation of major petroleum reserves. As the cotton sector weakened in response to a sustained drop in world prices and domestic inefficiency, banks began pulling out their investments. The IMF stepped in with a series of loan programs from 1978 through 1984. That rescue effort appeared to be working until civil war erupted in 1984 and culminated in a coup d'état the following year. Attempts by IMF management and donor countries to negotiate a solution to the arrears problems with the new government eventually broke down, and in February 1986 the Executive Board declared Sudan ineligible to use Fund resources.

No progress was made over the next three years, despite occasional agreements on policy adjustments. The Fund maintained a resident office in Khartoum and regularly sent staff missions, but agreement on policies was elusive. Sudan made occasional payments to the Fund that were just a small percentage of amounts falling due, while it continued to service obligations fully to the World Bank and other creditors. The authorities insisted they were trying to cooperate while confronting terrible economic circumstances. Their payments to other creditors were necessary to preserve a flow of food and other essential imports. The World Bank, they noted, was providing net new loans in exchange for the repayment of earlier credits, while the Fund was making no such promises.<sup>73</sup> Although most of the Fund's Executive Directors empathized with the immense challenges Sudan faced, including prolonged droughts and a devastating civil war, they concluded that the fundamental problem was still the government's failure to carry out adequate economic policy reforms.

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<sup>72</sup>Matters continued to deteriorate for several more years, and in March 2003, the Fund suspended Liberia's voting rights. The civil war ended a few months later, after which a spirit of cooperation returned. By then, the Liberian economy was in desperate condition, but the government resumed making small repayments on its long-overdue loans. In 2006, following the democratic election of Ellen Johnson-Sirleaf as president, the Fund agreed to a staff-monitored program, and it began to unwind the remedial measures taken earlier. Liberia repaid its arrears in March 2008 with help from bilateral donors, and the Fund responded by fully restoring Liberia's rights.

<sup>73</sup>The staff analysis of the impasse was summarized in "Sudan—Overdue Financial Obligations to the Fund—Further Review Following Declaration of Ineligibility," EBS/90/133 (July 16, 1990). The Sudanese authorities' views were conveyed to the Fund by their Executive Director, El Tayeb El Kogali, at EBM/90/119 (July 23, 1990).

The strengthened arrears strategy adopted in July 1989 gave the Fund new leverage with which to try to pull or push the authorities into a more productive and cooperative stance. The policy dialogue and the promise of technical assistance were the carrots. If they failed to induce the desired response, the remedial sticks would come into play. By mid-1990, the Fund was convinced Sudan was not responding adequately, and it prepared to take further action against the country.

In July 1990, Camdessus proposed that the Fund should declare publicly that Sudan was not cooperating. As described above, the Fund had made such a declaration only once before, with regard to Liberia. In this case, the Executive Board was hesitant to act because many Directors thought Sudan was genuinely trying but lacked the resources to do more. After several hours of debate, the Board agreed to give the authorities two more months to improve policies and increase the flow of payments to the Fund. In September, after a further staff mission concluded the situation was not going to improve, the Fund issued its second declaration of noncooperation. In contrast to the declaration on Liberia, however, the Board softened the message a bit by pointedly omitting any reference to this being a step toward compulsory withdrawal. Instead, the declaration noted only that if Sudan did not resume "active cooperation . . . , the Fund will give consideration to the initiation of further procedures in accordance with the strengthened arrears strategy within nine months of the date of this decision."<sup>74</sup>

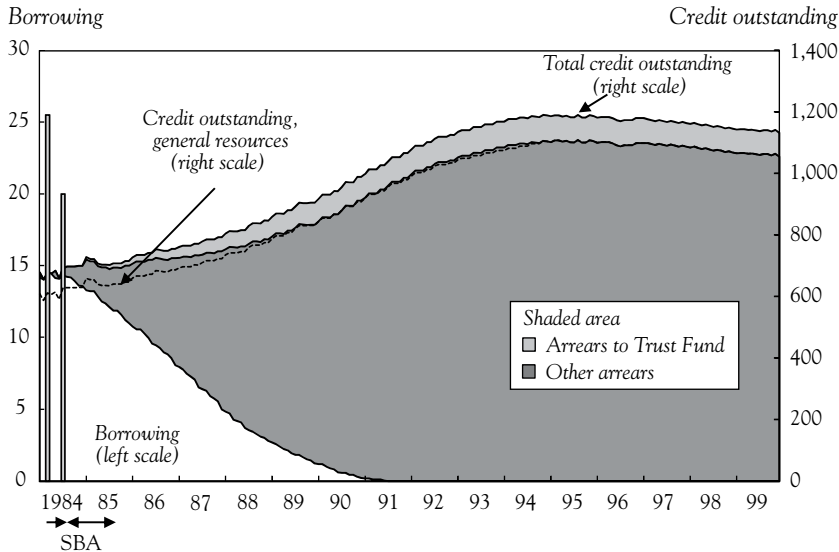
During the next two years, relations between Sudan and the Fund gradually improved. By the middle of 1992, economic conditions were on much more solid footing (good output growth driven by favorable agricultural conditions; moderate price inflation), and macroeconomic policies appeared to be sustainable. In response, the Fund was monitoring policy implementation and was open to considering a RAP if Sudan would agree to avoid any further accumulation of arrears.<sup>75</sup> That requirement, though, was becoming much harder to meet. Sudan now owed the Fund more than \$1.5 billion, all of which was in arrears (Figure 16.11). Annual interest and related charges were expected to total more than \$60 million a year, or about 20 percent of Sudan's total export earnings. Moreover, Sudan had about \$11 billion in other external debt also in arrears. Sudan simply could not service these debts and avoid further accumulation of arrears without substantial and continuing aid from donor countries.

Donors were totally disillusioned with Sudan. The military government in Khartoum, led by General Umar al-Bashir, was employing increasingly harsh tactics to try to win the civil war and impose control over the whole country. Bashir's stated support for Iraq's invasion of Kuwait in 1990 further alienated the regime from the international community. As a result, one country after another sharply reduced aid, and by

<sup>74</sup>The decision was adopted on July 23, 1990, and it took effect without further deliberation by the Executive Board on September 14; see minutes of EBM/90/120 (July 23, 1990), pp. 8–9; and EBM/90/142 (September 14, 1990), p. 3.

<sup>75</sup>See "Sudan—Overdue Financial Obligations to the Fund—Further Review Following Declaration of Ineligibility," EBS/92/195 (November 30, 1992).

**Figure 16.11. Sudan: Use of Fund Credit, 1984–99**  
(In millions of SDRs, monthly data)



Source: International Financial Statistics; see Figure 16.2 for further explanation.

Note: SBA = Stand-by arrangement.

late 1992 Sudan was receiving only enough assistance to cover the population’s most basic food requirements. Until a measure of political respectability could be restored, no resumption of donor support could be expected. Without donor support, Sudan had no hope of normalizing its relations with the IMF.

In the first half of 1993, Sudan’s payments to the Fund slowed to a trickle, and implementation of economic policies worsened. As the staff-monitored program lapsed, management began considering further actions. The adoption of the Third Amendment in November 1992 made it possible to take some additional intermediate steps without rushing too rapidly toward the ultimate step of expelling the country from Fund membership. In particular, the member’s voting rights could be suspended if the Fund determined the authorities had been failing to cooperate over an extended period. The Managing Director issued a complaint to that effect in June 1993, and in August the Board took the strongest action it had yet taken in a case of protracted arrears.

The Board meeting of August 6, 1993, was an extraordinary occasion. Both the minister of finance and the central bank governor came from Sudan to plead for sympathy and understanding and to state unequivocally their desire to cooperate and remain in good standing with the Fund. Directors were moved by the suffering of the Sudanese people, but most were convinced the solution rested with the authorities in Khartoum, not with the international community. The decision to suspend Sudan’s

voting rights did not, however, come easily. Several chairs expressed their reluctance and regret, and some noted dissent within their own constituencies. Four chairs—the constituencies led by Egypt and the Islamic Republic of Iran, and both of the sub-Saharan African groups—voted against the proposed decision, and three others—China, France, and the Russian Federation—abstained. Suspension required approval of 70 percent of the voting power, and passage hung in the balance until the very end of the meeting. The Executive Director for India, K.P. Geethakrishnan, tried to muster a simple majority for postponing a decision until another staff mission could reassess prospects for an improvement. When that effort failed, he “very reluctantly supported the proposed decision.” With that, the proposal was adopted with 71.6 percent in favor.<sup>76</sup>

For the next several months, little progress was evident. In April 1994, the Managing Director issued a further complaint that Sudan had “persisted in its failure to fulfill its obligations under the Articles of Agreement.” As the Board prepared to consider that complaint and initiate procedures that would lead eventually to the expulsion of Sudan, the Bashir government committed itself to do whatever was required to truncate that process. At the end of April, at the request of the authorities, the Fund sent Paul Chabrier (Director, Middle Eastern Department) and a few other staff to Khartoum. That visit led to an agreement by the authorities to increase their payments to the Fund substantially, to stabilize and begin to reduce the total balance outstanding.<sup>77</sup> Doing so took several more months, but Sudan’s arrears finally peaked in November, after which they declined very slowly (see Figure 16.11). In January 1995, as a gesture of *détente*, the Fund resumed providing technical assistance to Sudan.

Despite this renewed cooperation, the Fund applied further pressure in 1996. Although Sudan had continued making payments, the timing had become sporadic. Policy implementation was similarly spotty. The best that could be expected at this point was for the stock of outstanding obligations to creep down very gradually. Accordingly, the staff concluded Sudan “has not strengthened cooperation with the Fund in seeking a solution to the problem of its overdue financial obligations to the Fund,” and the Managing Director asked the Executive Board to consider compelling the member to withdraw.

The Board discussed the matter in February 1996, but Directors were deeply divided between those who wanted to give a positive response to Sudan’s modest but encouraging efforts and those who wanted to send a strong signal that protracted arrears would not be tolerated. Stanley Fischer (First Deputy Managing Director), who was chairing the meeting, reminded the Board its options were actually limited. If the Board recommended expelling Sudan but the Board of Governors failed to approve it by the required 85 percent majority, the Fund’s credibility and effectiveness could suffer.

<sup>76</sup>Minutes of EBM/93/142 (August 6, 1993).

<sup>77</sup>See “Complaint under Article XXVI, Section 2(c) with Respect to Compulsory Withdrawal of Sudan from the Fund,” EBS/94/77 (April 8, 1994); and minutes of EBM/94/43 (May 16, 1994), p. 23.



Moreover, if the Fund did expel Sudan, it would lose any chance of recovering the outstanding balances, and the whole membership would pay a heavy price. After much debate, the Board agreed unanimously to state “that it would expect to recommend that . . . the Board of Governors require Sudan to withdraw from the Fund unless the Executive Board determines by August 2, 1996 that Sudan has strengthened its cooperation with the Fund.” Thus, the Fund put Sudan on notice that it had just six months to make substantial progress.<sup>78</sup>

Sudan made considerable efforts to improve its economic performance and whittle away at the arrears. Beginning in 1997, the Fund responded by providing technical assistance and monitoring policy implementation. After two years during which Sudan managed to reduce its outstanding arrears slowly but steadily, the Fund agreed to begin de-escalating its remedial measures. The United States objected strongly because it considered Sudan’s economic policies inadequate and its record of payments to the Fund weak. De-escalation, in the view of the U.S. chair, was “ill-advised.” The United States therefore voted against easing up on Sudan, but it received no support from other Executive Directors. As Stephen Collins (Alternate, United Kingdom) remarked, “this cooperative strategy is sort of a carrot and stick, and I think more of the carrot is appropriate in this case, within limits.”<sup>79</sup>

Eliminating Sudan’s huge arrears was impossible as long as Sudan remained politically isolated from the international community, but the Fund recognized the need to reward the authorities’ efforts to cooperate. On August 27, 1999, the Board terminated the declaration of noncooperation and established a plan to restore the country’s voting rights the following year.

## **Somalia**

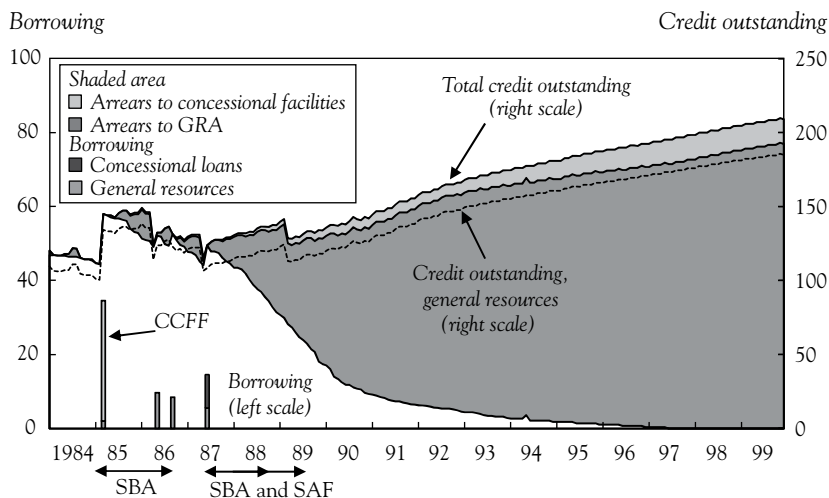
The IMF lent heavily to Somalia in the early 1980s. The country’s policies were reasonably sound then, but external shocks were battering its economy. Even though the authorities fell behind in servicing their debts several times through the middle of the decade, the Fund kept lending until 1987 out of a conviction the government—besieged by an insurgency as well as by economic shocks—deserved international support. Performance then deteriorated rapidly, and from July 1987 Somalia was no longer able to keep up with the repayment schedule. In May 1988, the Fund declared Somalia ineligible for further borrowing (Boughton, 2001, pp. 795–98).

For the next two years, the authorities worked diligently with the staffs of the IMF and the World Bank to prepare a Policy Framework Paper. That effort succeeded and

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<sup>78</sup>Minutes of EBM/96/10 (February 13, 1996). Fischer’s warning is on p. 38. The formal decision is on pp. 41–42.

<sup>79</sup>Minutes of EBM/99/94 (August 27, 1999), pp. 108–50. The U.S. statement, delivered by S.P. Donovan (Advisor to the Executive Director), is on pp. 135–37. Collins’s remarks immediately follow Donovan’s. The de-escalation decision, with the United States voting no, is at the end.

**Figure 16.12. Somalia: Use of Fund Credit, 1984–99***(In millions of SDRs, monthly data)*

Source: International Financial Statistics; see Figure 16.2 for further explanation.

Note: CCFF = Compensatory and Contingency Financing Facility; GRA = General Resources Account; SAF = Structural Adjustment Facility; SBA = Stand-by arrangement.

put Somalia in position for new loans if it could obtain the resources to settle its arrears. The Italian government formed a donors' support group, and for a brief moment Somalia's prospects seemed to be brightening. Tragically, by 1990 the country's persistent economic stagnation was resulting in political chaos as a variety of warlords began staking claim to territories around the country. When the IMF Executive Board met in October 1990 to review Somalia's overdue obligations, the government was rapidly losing control. Although Somalia had—almost miraculously, considering the circumstances—paid \$1.35 million to the Fund since the previous review, that amount was not nearly enough to stabilize arrears (Figure 16.12). Because the authorities were making an effort but were unable to deliver either on payments to the Fund or on policy implementation, the Fund sought to find an appropriate middle ground in its response. The Board decision referred to “the absence of Somalia's active cooperation with the Fund,” but it postponed a decision on issuing a formal declaration of noncooperation.<sup>80</sup>

That was the last review of Somalia's arrears for many years. Rebel forces overthrew the government in January 1991 but were unable to establish an effective replacement.

<sup>80</sup>Minutes of EBM/90/154 (October 26, 1990), pp. 51–52.

From that point on, Somalia had no recognized authority with whom the IMF could communicate.<sup>81</sup> All further remedial actions were put on hold.

### **More Setbacks: New Cases of Arrears**

In addition to the difficulty of resolving old cases of arrears, the Fund had to cope with several fresh developments. Most of the new cases arose as a result of severe internal political and security problems. All of these new arrears were settled, either within the decade or shortly thereafter.<sup>82</sup>

#### ***The Dominican Republic***

As discussed in Chapter 9, the Dominican Republic suffered a debt crisis in 1989 that led it to suspend payments to the IMF and other creditors. The authorities continued to work with Fund staff to try to resolve the problem, so neither management nor the Executive Board wanted to force the issue by taking a strong position. This cooperation resulted in a settlement of overdue obligations in August 1990, but the country missed the next payment and began rebuilding arrears (Figure 16.13).

By any reasonable standard, the Dominican Republic—a small island economy, vulnerable to external shocks, and with an income level on the border between low- and middle-income classification—was making a strong effort to stay current on its debt service. Its payments to the Fund were steadily reducing the total outstanding, though not adequately to keep up with the required schedule. The authorities were working with the staff, led by Claudio Loser (Deputy Director, Western Hemisphere Department), to develop an acceptable policy program for the coming year. Nonetheless, the prospect of a new wave of arrears cases worried many of the Fund's major creditor countries, and they were determined to take a firm stand to bring early closure to this one.

Camdessus preferred to focus on the positive steps the Dominican Republic was taking, to make it easier for the authorities to maintain domestic political support for servicing external debt. He issued a standard complaint to the Executive Board under the Fund's Rule K-1, which would lead to a Fund decision formally suspending disbursements until the country was current on its repayments. He declined, however, to initiate a move to declare the country ineligible to use Fund resources.<sup>83</sup> He also

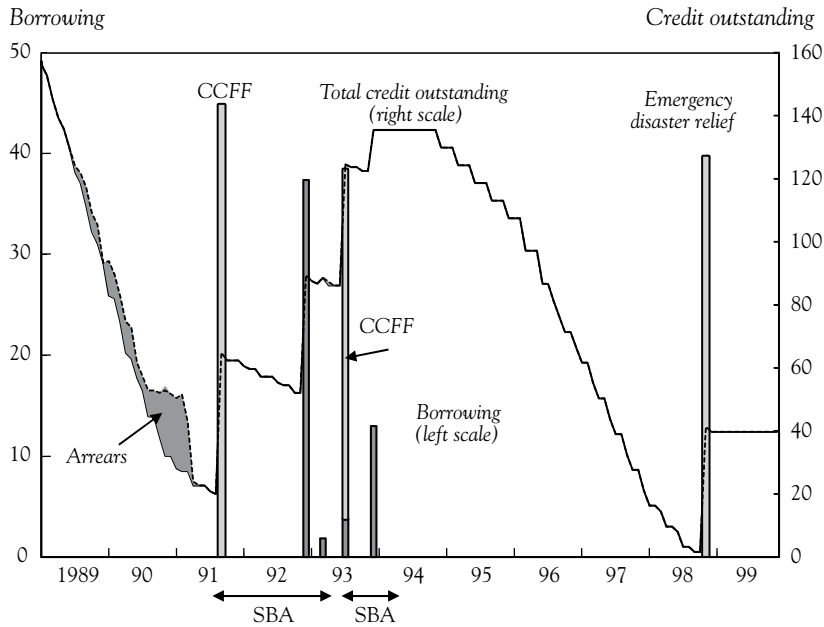
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<sup>81</sup>In September 1992, the Chairman of the Annual Meetings received notices of delegations from two competing groups claiming to be the government of Somalia. He decided not to seat either delegation. The Executive Board then decided not to recognize a Governor for the member; see "Certain Aspects of the Fund's Relations with Haiti, Somalia, and Yugoslavia," EBS/92/242 (October 9, 1992).

<sup>82</sup>This review omits several countries that experienced slight temporary delays in meeting financial obligations.

<sup>83</sup>These measures were largely symbolic; all countries with arrears were automatically prohibited from further borrowing.

**Figure 16.13. Dominican Republic: Use of Fund Credit, 1989–99**  
*(In millions of SDRs, monthly data)*



Source: International Financial Statistics; see Figure 16.2 for further explanation.  
 Note: CCFF = Compensatory and Contingency Financing Facility; SBA = Stand-by arrangement.

advised against sending a letter to IMF Governors alerting them to these developments. Just a few months earlier, the Fund had adopted a new policy to send such letters (see above, p. 806). However, the Managing Director concluded in this case that the letter could create a “negative perception” of the Dominican Republic among potential donors and that it could undermine the “good prospects for an agreement” to settle arrears, strengthen economic policies, and lay the groundwork for new lending by the IMF.<sup>84</sup>

The Executive Board overruled Camdessus and insisted he write to Governors and inform them of the Dominican Republic’s arrears to the Fund. Seven chairs, representing all of the Group of Seven (G7) countries except France, plus the Netherlands, spoke in favor of taking this action. The Dean of the Executive Board, Alexandre Kafka (Brazil), supported the Managing Director, as did the French and Mexican chairs. Other Directors were silent, and the Secretary declared the creditor group to

<sup>84</sup>Minutes of EBM/90/177 (December 19, 1990), p. 29. The K-1 complaint was issued on November 21, 1990, and the Board approved the suspension of access to Fund resources on December 19.

have the majority.<sup>85</sup> Camdessus promptly sent the required letter, couched in the mildest possible terms, to a select group of potential donors or supporters. It read, in part,

While the Executive Board recognizes the Dominican Republic's recent efforts, it views with concern this emergence of a new case of arrears to the Fund. Executive Directors stressed that further actions by the Dominican Republic are necessary to adopt appropriate policies and to settle the overdue obligations to the Fund. They also emphasized that the international community should stand ready to provide support for such efforts. In that spirit, I would greatly appreciate any assistance [your country] . . . may be able to provide in encouraging and facilitating the efforts of the Dominican Republic to adopt a suitable adjustment program and to effect full and prompt settlement of its overdue financial obligations to the Fund. I have no doubt that your Government will support the Dominican Republic in its efforts in these respects.<sup>86</sup>

For the next few months, the authorities and the Fund staff continued to negotiate a new policy program the Fund could support. Along with other multilateral agencies, they also tried to solicit financial support from donor countries to help settle arrears. Although the program negotiations eventually succeeded, the fundraising effort largely failed. In February 1991, the European Commission released a previously scheduled grant of approximately \$120 million for budgetary support, but no country came forward with an offer to help settle arrears to the Fund. Despite this cold shoulder, the Dominican Republic used its own available resources to settle its \$33 million in arrears in March and April. The Fund then approved new loans, which were drawn and repaid on schedule.

## **Haiti**

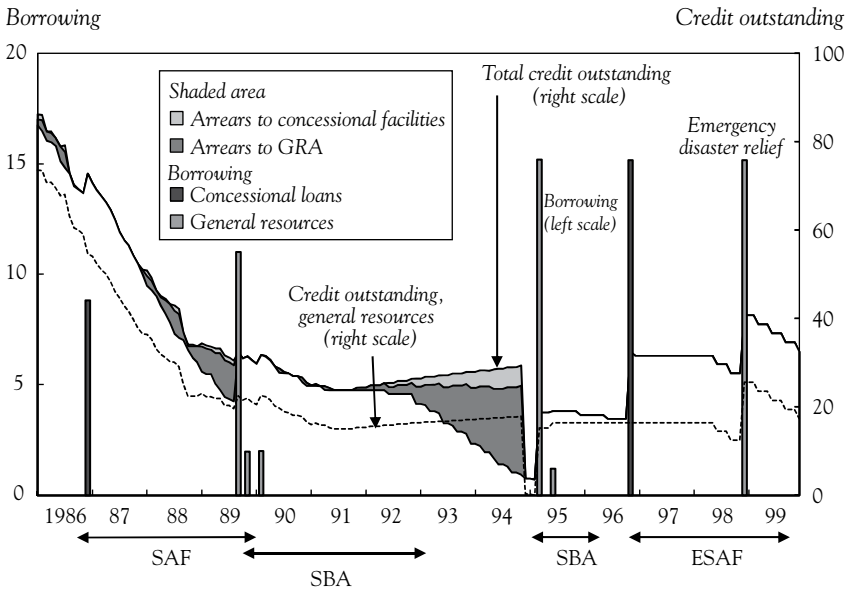
Haiti—the poorest country in the western hemisphere, sharing the island of Hispaniola with the Dominican Republic—suffered a series of political upheavals in the 1980s and 1990s that dragged its economy down even further. From 1957 to 1986, the country was ruled by a dictatorial regime led first by François Duvalier and then by his son, Jean-Claude Duvalier (“Papa Doc” and “Baby Doc” in the popular press). Throughout that time, the IMF provided relatively small but regular financial support: 20 annual stand-by arrangements and one three-year extended arrangement, plus a series of Trust Fund loans and Compensatory Financing Facility drawings. The amounts outstanding were always manageable, peaking in 1984 at \$109 million (SDR 103.3 million, or 248 percent of quota), and were repaid on time. The popular overthrow of Jean-Claude Duvalier in February 1986, brought on by the regime's increasingly brutal suppression of human rights and its inability to manage the economy, ended this fragile equilibrium.

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<sup>85</sup>Minutes of EBM/90/177 (December 19, 1990), pp. 28–35. The seven constituencies in favor held 49.6 percent of the voting power on the Executive Board.

<sup>86</sup>“Dominican Republic—Communications from the Fund Regarding Overdue Financial Obligations,” EBS/90/199, Suppl. 3 (December 27, 1990), p. 3.

**Figure 16.14. Haiti: Use of Fund Credit, 1986–99**  
(In millions of SDRs, monthly data)



Source: International Financial Statistics; see Figure 16.2 for further explanation.  
 Note: ESAF = Enhanced Structural Adjustment Facility; GRA = General Resources Account;  
 SAF = Structural Adjustment Facility; SBA = Stand-by arrangement.

Initially, the IMF responded positively to Haiti’s attempts to establish democracy and restart economic growth. The Executive Board approved a \$25 million SAF arrangement in December 1986 and disbursed \$10.6 million immediately. Over the next few years, however, the provisional governments that succeeded to power struggled to maintain enough international support to preserve fiscal balance while providing a minimum of social services to the people. They also struggled to keep up with the schedule for servicing their outstanding debts to the IMF and other creditors. In July 1988, the Managing Director notified Directors that a “curtailment of external aid flows” against “a background of political uncertainty” had made it difficult for Haiti to meet its financial obligations. Until recently, the authorities had been able to keep the delay in paying the Fund to less than a month, but now the slippage was increasing. The Board was generally sympathetic, and the Fund postponed taking any action. Haiti settled its arrears in October, and the Managing Director withdrew the complaint.<sup>87</sup>

<sup>87</sup>Haiti—Overdue Financial Obligations to the Fund—Report and Complaint under Rule K1 and Rule S1,” EBS/88/134 (July 11, 1988), p. 2; and “Haiti—Settlement of Overdue Financial Obligations to the Fund, and Withdrawal of Complaint under Rule K-1,” EBS/88/173, Suppl. 3 (October 26, 1988).

Progress was short-lived. Haiti immediately missed the next payment and was in arrears for the next year. Once again, however, the government settled its accounts. In September 1989, the Fund approved a \$26 million stand-by arrangement (SDR 21 million, or 47 percent of quota) and disbursed more than half of that amount at once. Haiti thus did not have to make any net payment to the Fund (Figure 16.14).

Delays began again in 1990. Meanwhile, Haiti moved toward democratic reform, holding its first free elections that year. Jean-Bertrand Aristide was elected president. He took office in February 1991 but was overthrown in a military coup in September. Political and economic chaos then overtook Haiti. In an effort to force the military to return power to the democratically elected government, the Organization of American States (OAS) imposed a trade embargo and blocked the transfer of Haitian financial assets held abroad (mostly in the United States). Although the military government told the IMF it was willing to service its debts, it obviously could not do so without first regaining access to its foreign exchange reserves. The next payments to the Fund were due in November 1991. Those payments were not made, nor were the ones that should have followed. The Managing Director responded in January 1992 by issuing a second formal complaint.<sup>88</sup>

Although the horrendous economic and social conditions in Haiti would have been enough justification for the country's external debt crisis, a more fundamentally political problem arose in 1991. The international community, working through the UN as well as the OAS, was determined to apply pressure on several fronts to resolve the political crisis, which meant restoring Aristide to power. As Dawson (United States) put it in September 1992, it "was the strong view of [the U.S.] authorities, and of the authorities of most countries represented in the Executive Board, that the Aristide Government was, indeed, the legitimate Government of Haiti."<sup>89</sup> At that time, in anticipation of the IMF/World Bank Annual Meetings, both the military government in Port au Prince and the Aristide government-in-exile had submitted credentials and requested to be represented at the meetings. The agencies referred the matter to the Annual Meetings Chairman, who in turn referred it to the Joint Procedures Committee, a broadly representative group of Governors that convenes as necessary to advise the Chairman. The committee recommended, and the Chairman agreed, not to seat the delegation nominated by the military government and instead to seat the delegation representing the government-in-exile headed by Aristide. Shortly afterward, the Executive Board also decided to deal only with the Aristide government.<sup>90</sup> That government, as everyone clearly understood, had no resources of its own to service the country's debts.

<sup>88</sup>"Haiti—Overdue Financial Obligations to the Fund—Report and Complaint under Rule K1 and Rule S1," EBS/92/9 (January 21, 1992).

<sup>89</sup>Minutes of EBM/92/119 (September 16, 1992), p. 50. The Executive Director for Haiti, Alexandre Kafka (Brazil), was not present at that meeting.

<sup>90</sup>"Certain Aspects of the Fund's Relations with Haiti, Somalia, and Yugoslavia," EBD/92/242 (October 9, 1992), p. 2.

With these peculiar circumstances in mind, the Fund declined to take further remedial actions against Haiti. Instead, it simply waited until the political stalemate could be resolved. In September 1994, a multinational military force, led by U.S. troops and acting on a resolution of the UN Security Council, entered Haiti to restore order and return Aristide to power. With that step completed, the settlement of arrears to the Fund and other external creditors proceeded apace. The U.S. government formed a support group of nine major donor countries that provided grants totaling \$643 million to enable Aristide to put the country's external accounts in order. That settlement included a payment of \$36 million to the Fund, which cleared all overdue obligations.

Political instability and economic stagnation soon returned. The Fund approved a front-loaded stand-by arrangement (the twenty-second for Haiti) in February 1995 but allowed only the initial drawing and one more. An ESAF arrangement followed in 1996 but again only the first disbursement was allowed owing to a weakening of policies and a shortfall in bilateral aid inflows. The only other Fund lending in the 1990s occurred in December 1998, in the form of emergency disaster relief following a major hurricane. Nonetheless, Haiti managed to meet its repayment obligations on time.

### **Yugoslavia**

The Socialist Federal Republic of Yugoslavia disintegrated in 1990–92, as long-standing economic weaknesses led to and were in turn reinforced by political division. The IMF, which had lent regularly to Yugoslavia throughout the 1980s, made one last attempt to support the government's stabilization efforts by approving a stand-by arrangement in March 1990. The initial drawing on that arrangement raised Yugoslavia's indebtedness to the Fund to some \$686 million (SDR 527.6 million, or 86 percent of quota). As the economic and social fabric of the country began to dissolve, the Fund put further disbursements on hold. In September 1992, as the last vestiges of political cohesion were vanishing, Yugoslavia began to accumulate arrears to the Fund.

The five initial successor states—Bosnia and Herzegovina, Croatia, the Federal Republic of Yugoslavia (Serbia and Montenegro), the former Yugoslav Republic (FYR) of Macedonia, and Slovenia—each inherited a share of the federation's quota, assets, and liabilities in the IMF, including the outstanding obligations in arrears. At the end of 1992, Yugoslavia's indebtedness to the Fund amounted to about \$215 million, of which some \$65 million was in arrears.

As explained in Chapter 2, the Fund responded to the uniqueness of this situation by making several ad hoc decisions regarding the conditions for the successor states to accede to Fund membership. In particular, each state had to settle its share of Yugoslavia's arrears before it could become a member. Once it completed that step and the other requirements, it would be considered to have been a member without interruption since December 14, 1992, and to have continued, for its share, the membership of Yugoslavia in the Fund. That legal formality ensured that Yugoslavia's assets and liabilities in the Fund would have clear and continuous ownership.



Three of the successor states—Croatia, FYR Macedonia, and Slovenia—cleared arrears and succeeded to their shares of the Yugoslav membership within a few months. The other two—Bosnia and Herzegovina, and Serbia and Montenegro—were embroiled in conflicts and were placed under international sanctions. They therefore were not able to clear their arrears to the Fund until much later. Bosnia and Herzegovina cleared its arrears in December 1995 with the help of a bridging loan from the Netherlands Central Bank, shortly after the Dayton peace accords ended the inter-ethnic war in the country (see Figure 6.3). Serbia and Montenegro completed the settlement of the former federation's arrears five years later, using the proceeds of bridge loans from Norway and Switzerland.

### ***The Central African Republic***

As discussed in Chapter 14, the CFA franc zone in central and west Africa experienced extensive economic setbacks throughout the late 1980s and early 1990s. The international effort to help resolve those difficulties culminated in a devaluation of the common currency in January 1994, accompanied by the adoption of comprehensive economic stabilization and reform plans in each of the participating countries. The IMF supported that effort with technical assistance and new lending. Several countries in the franc zone experienced temporary delays in meeting their financial obligations to the Fund, both before and after the 1994 devaluation, but only the Central African Republic developed protracted arrears.

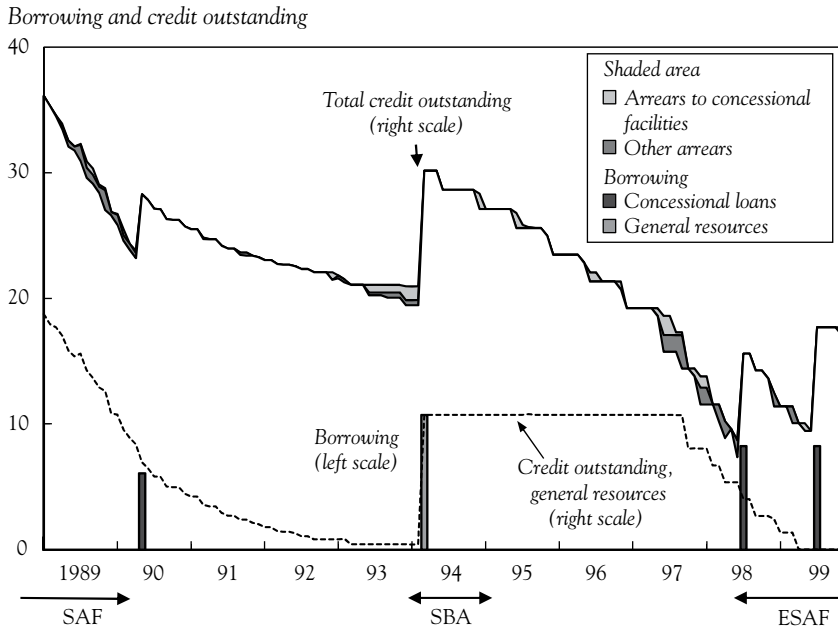
As is evident in Figure 16.15, the Central African Republic's arrears were small in relation to total credit outstanding, but they recurred frequently. From 1989 to 1998, the authorities fell behind in their payments on eight separate occasions, but they were able to get caught up in less than six months with just one exception. The Managing Director issued a complaint in 1989 and again in 1993. Only in 1993–94 did the problem threaten to get out of hand. In that case, however, by the time the six-month threshold was reached, the Fund was on the verge of negotiating the devaluation that would trigger large-scale donor support as well as new lending by the Fund and other multilateral agencies. In a December 1993 review, the Executive Board decided to postpone further action for three months, by which time the country cleared its arrears.

Finally, two cases of arrears arose in the 1990s, remained outstanding at the end of the decade, and were settled a few years later.

### ***The Democratic Republic of the Congo***

The history of relations between the IMF and the Democratic Republic of the Congo is an unhappy one and has been so throughout an unusually long period. From the mid-1970s through the 1980s, the Fund lent regularly to Zaïre, as the country was then known, despite realizing that the country's people were likely to benefit little from the proceeds. President Mobutu Sese Seko and his associates were notoriously corrupt, but the Fund tried to avoid being drawn into political judgments regarding a government that enjoyed widespread international support.

**Figure 16.15. Central African Republic: Use of Fund Credit, 1989–99**  
(In millions of SDRs, monthly data)



Source: International Financial Statistics; see Figure 16.2 for further explanation.

Note: ESAF = Enhanced Structural Adjustment Facility; SAF = Structural Adjustment Facility; SBA = Stand-by arrangement.

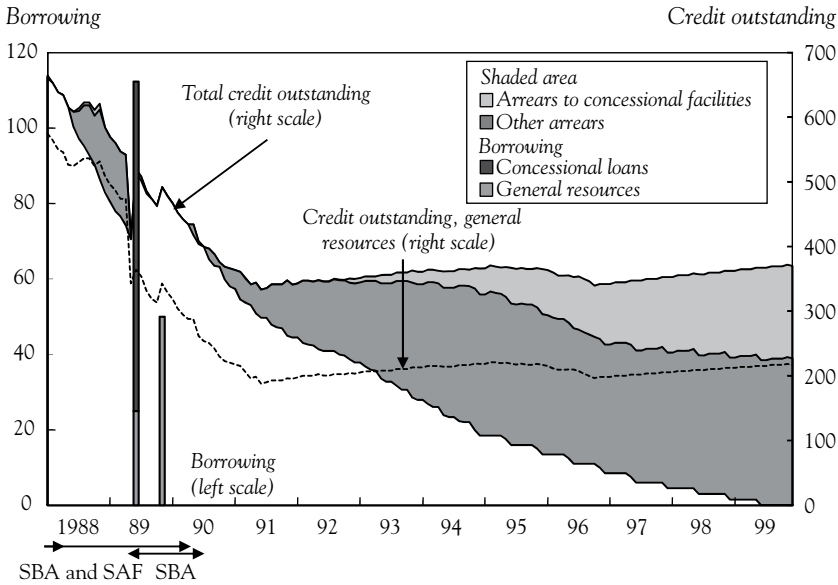
Occasional efforts by management and the staff to limit the damage were unsuccessful. Zaïre's indebtedness to the Fund rose to a peak of some \$875 million in 1986 before tapering off. By 1988, Mobutu came to resent that he had to make net repayments to the Fund, especially because he was under pressure at home to keep up a semblance of economic growth in the face of massive inefficiency in the management of the economy. For about a year, Zaïre deliberately fell behind in those repayments, before settling up in May 1989 (Figure 16.16).<sup>91</sup>

In November 1990, Zaïre again went into arrears to the Fund, and this time no imminent repayment was in sight. Mobutu's grip on power was slipping because he was less and less able to keep up the system of patronage that had made that power possible. His international support was also waning, partly because of the breakdown in social order caused by the government's inability even to pay wages regularly and partly because the end of the Cold War rendered him less useful to European and American patrons. Mobutu's incentive to meet his external financial obligations simply disappeared.

The Fund responded forcefully to Zaïre's unwillingness to repay its loans. In September 1991, the Executive Board declared Zaïre to be ineligible to use Fund resources.

<sup>91</sup>These developments are covered in Boughton (2001), pp. 804–10.

**Figure 16.16. Democratic Republic of the Congo: Use of Fund Credit, 1988–99**  
(In millions of SDRs, monthly data)



Source: International Financial Statistics; see Figure 16.2 for further explanation.  
Note: SAF = Structural Adjustment Facility; SBA = Stand-by arrangement.

Five months later, it issued a public declaration of noncooperation. At the time, an international coalition led by Belgium, France, and the United States was pressing Mobutu to resolve the domestic political stalemate and form a broadly based coalition government. In the absence of such a solution, the economy was no longer functioning. At the Executive Board meeting, only the French Director (Jean-Pierre Landau) and the two Directors from sub-Saharan Africa (L.B. Monyake, from Lesotho, and Corentino V. Santos, from Cape Verde) argued for a delay in declaring Zaïre not to be cooperating, to give the democratization process more time to succeed. Even the Belgian chair supported the staff proposal. Mobutu had few friends left in the world.<sup>92</sup>

For the next several years, the IMF's response to initiatives from Zaïre continued to be driven largely by political developments. After two years of stalemate in which rival governments vied for power in Zaïre and the authorities made only token payments on their arrears, the Fund suspended the member's voting rights. The formation of a new government in 1994, with Léon Kengo wa Dondo serving as prime minister and Mobutu remaining in power as head of state, led to a renewed effort to stabilize the economy. Zaïre stepped up its payments, roughly stabilizing total arrears for a brief

<sup>92</sup>Minutes of EBM/92/17 (February 14, 1992). The Executive Director for Belgium, Jacques de Groote, did not participate in the meeting. He was represented by his long-time Advisor, Frank Moss (also from Belgium).

period. The Fund responded by resuming technical assistance and postponing consideration of steps leading to compulsory withdrawal.

In May 1997, rebel forces led by Laurent-Désiré Kabila overthrew Mobutu, who fled to exile in Togo. Kabila revived the previous name of the country, the Democratic Republic of the Congo. Within a year, the new authorities promised to stabilize arrears again, but they failed to make good on that promise. A new civil war ensued, and the Fund continued to postpone further action until the military and political situation could stabilize. Only after the assassination of Kabila and the assumption of power by his son, Joseph Kabila, were the authorities able to make a serious effort to restart economic activity and normalize relations with external creditors. The Democratic Republic of the Congo settled its arrears in June 2002, and the Fund began lending to it through the Poverty Reduction and Growth Facility.

### ***Iraq and Afghanistan***

Similarly to Haiti, Iraq was forced into arrears as a result of sanctions imposed by the international community. The sanctions were a response to Iraq's invasion of Kuwait in August 1990, which touched off the Gulf War of 1991. Under a UN resolution, Iraq had no access to its assets held abroad, and the authorities insisted they could not make any payments to the IMF except by using those assets. Fund officials were singularly unimpressed by this argument, especially because the outstanding balance was small. Iraq had no outstanding debts to the GRA, but for several years it had drawn its holdings of SDRs down to zero. It therefore had to use its own resources to pay the interest due on the difference between its actual holdings (zero) and its allocation (SDR 68.5 million). For 1990, that amounted to about \$2.2 million, or 0.3 percent of Iraq's quota in the Fund.<sup>93</sup> A stalemate followed, in which arrears to the SDR Department continued to accumulate while the Fund took no further action to try to collect. Eventually, following the U.S.-led military overthrow of Saddam Hussein, the new government settled Iraq's accounts in September 2004 by paying accumulated interest of some \$81 million.

Afghanistan, which also had no general obligations outstanding, ran out of SDR holdings in November 1995. For several years before then, the country had been in a state of civil war, waged in the near vacuum of governance created by the departure of Soviet troops in 1989. From 1993 on, the Fund had no reliable means of communicating with the authorities. As civil war raged, various parties tried to withdraw the \$7 million (SDR 4.9 million) balance in the reserve tranche, but the Fund demurred on the grounds it could not authenticate the validity of the requests.<sup>94</sup>

<sup>93</sup>Iraq—Overdue Financial Obligation to the Fund—Report and Complaint under Rule S1,” (EBS/91/13).

<sup>94</sup>See “Afghanistan—Overdue Financial Obligations to the Fund—Report and Complaint under Rule S1,” EBS/96/28 (February 27, 1996), p. 2.

The accession to power by the Taliban further isolated Afghanistan from the world economy. The member's SDR holdings were fully depleted (through periodic charges to cover the interest due) shortly thereafter. As with Iraq, the Managing Director issued a complaint under Rule S1, and the Fund just waited until the political situation improved. In October 2001, a U.S.-led military force attacked Afghanistan to dislodge the Taliban in retaliation for its role in enabling the terrorist attacks of September 11 that year. The success of that campaign led to a new government, which settled its arrears with the Fund soon thereafter.

## Conclusions

The potential cost to the IMF of the accumulation of arrears in the 1980s and 1990s, and the risks to the Fund while the problem persisted, were both immense. For the cases resolved successfully, however, the final cost to the institution was small. As long as each country eventually repays the Fund, in full and including overdue interest, the long-run cost to the Fund is just the administrative cost of developing and administering policies and of helping the country resolve the problem. The broader cost to the Fund's membership is more complicated to assess.

In most of the cases resolved in the 1990s, the indebted country obtained bridge loans from a group of donor countries to repay the Fund. The clearance of arrears was usually completed in tandem and in cooperation with the World Bank and other multilateral institutions. New lending from the Fund and others enabled the country to repay those bridge loans, usually within a few days. A renewal of arrears never followed a successful resolution. In several cases, including Cambodia, Guyana, Sierra Leone, and Vietnam, the indebted country also obtained grants from donors, either tied directly to the clearance of arrears or to provide fresh budgetary support for a new Fund-supported program. Whether those grants would have been smaller in the absence of the prior arrears is hard to judge. None of these countries obtained debt relief through the Heavily Indebted Poor Countries Initiative in the 1990s. Creditor and debtor countries helped cover the risks to the Fund through burden sharing contributions, but those contributions are repayable when all arrears are settled, or possibly earlier. On balance, therefore, even the secondary costs to donor countries do not appear to have been large in most cases.

The remaining issue, 10 years later, is whether the last two arrears cases from this era—Somalia and Sudan—will ultimately be resolved as successfully. History shows that the prerequisite is a return to political stability. Only then can the Fund work together with the authorities to begin a new and more positive relationship.

## Other Policies to Safeguard IMF Resources

As a cooperative multilateral agency, the IMF depends heavily on data provided by its member countries. Accurate data are crucially important both for

surveillance, through which the Fund is trying to assess the appropriateness of members' policies, and for lending operations, through which the Fund is trying to assess whether a country needs financial assistance and whether it is using the Fund's financing properly to resolve its underlying economic problems. For these purposes, although the staff itself does extensive data collection during missions to each country, the Fund generally trusts that its members have provided accurate data unless it has good reason to question that data. Without accurate data from borrowers, the Fund cannot be assured that its financing is being used for the intended purposes. In the 1990s, misreporting became an issue for the first time, and the Fund had to develop new policies to deal with the problem.<sup>95</sup>

The first major case in which the Fund lent to a country based on data the country's officials had deliberately distorted was a stand-by arrangement with Hungary. The Hungarian government in the 1980s regularly reported one set of data to western creditors, including the Fund, and maintained a second and more accurate set of accounts for internal use. The reported data understated fiscal deficits and the resulting debt burden, and correspondingly overstated the central bank's foreign exchange reserves. As the date for Hungary's first modern democratic elections approached in 1989, central bank officials realized they would soon have to reveal the true state of the country's finances. When they informed the Fund, the staff discovered Hungary would not have been eligible to make three of the drawings of the preceding years if accurate data had been used. The Fund required Hungary to repay those loans before it would approve any new arrangements. The government agreed, and the matter was resolved even before the newly elected government took office.<sup>96</sup>

Through the rest of the 1990s, the Fund encountered 10 other cases of misreporting, involving nine countries (Table 16.2). Only four instances—misreporting by Ethiopia, Jordan, Russia, and Ukraine—were determined to have been most likely deliberate. In three other cases—Pakistan, the Philippines, and Tajikistan—the discrepancies appeared to have resulted from weaknesses in the authorities' administrative capacity. The origins of the remainder—misreporting by the Kyrgyz Republic and Romania—were unclear. The Fund's official guidelines for handling such problems did not distinguish between intentional and accidental misreporting, because the causes can be murky and the economic consequences are the same either way. As a practical matter,

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<sup>95</sup>In 1984, the Fund adopted specific guidelines for dealing with misreporting of data. The first instances of data misreported by borrowing countries came to light in the second half of the 1980s, but in each case—involving Zaïre and Mauritius in 1985, Senegal in 1986, and Mauritania in 1988—the Executive Board decided that the problem was minor, and it granted a waiver. For details, see "Misreporting of Information to the Fund—Policies, Procedures, and Remedies—Preliminary Considerations," EBS/00/12 (February 2, 2000).

<sup>96</sup>See Boughton (2001), pp. 985–86; and "Misreporting of Information to the Fund—Policies, Procedures, and Remedies—Preliminary Considerations," EBS/00/12 (February 2, 2000), pp. 30–31.

**Table 16.2. Misreporting of Data by Member Countries, 1990–99**

| Country         | Dates   | Date Considered by Fund | Covered by Guidelines? | Action Taken                               |
|-----------------|---------|-------------------------|------------------------|--|
| Hungary         | 1982–89 | February 21, 1990       | yes                    | repayment required                         |
| Philippines     | 1989    | April 9, 1990           | yes                    | waiver                                     |
| Ukraine         | 1995    | December 13, 1995       | yes                    | waiver                                     |
| Romania         | 1995–96 | May 8, 1996             | no                     | none                                       |
| Ethiopia        | 1996–97 | October 8, 1997         | no                     | suspension of lending                      |
| Ukraine         | 1998    | September 4, 1998       | no                     | closer monitoring of next arrangement      |
| Tajikistan      | 1998    | July 2, 1999            | yes                    | waiver                                     |
| Russian Fed.    | 1996    | July 28, 1999           | no                     | closer monitoring of next arrangement      |
| Pakistan        | 1999    | September 3, 1999       | yes                    | waiver                                     |
| Jordan          | 1996–97 | October 5, 1999         | no                     | suspension of lending; voluntary repayment |
| Kyrgyz Republic | 1996–98 | February 9, 2000        | no                     | none                                       |

Sources: See text.

however, the Fund was more likely to grant a waiver if it determined the discrepancy was unintentional.<sup>97</sup>

Of the four most serious cases, two have been described in earlier chapters—Russia in Chapter 7 and Ethiopia in Chapter 14—and they are summarized briefly here.<sup>98</sup>

In 1996, the Central Bank of **Russia** overstated its net international reserves, for example, by neglecting to report it had issued guarantees to cover risky transactions of certain commercial banks. An external audit in 1999 uncovered the discrepancy, by which point it was too late for the Fund to apply remedies under its misreporting guidelines. Nonetheless, when the Executive Board reviewed the matter, it required the minister of finance, Mikhail M. Kasianov, to sign a letter promising to retain the proceeds of the next Fund arrangement in Russia's account in the SDR Department. More strikingly, it took the unusual and frankly humiliating step of noting, in its decision approving the arrangement, that in “deciding whether to complete each review under the arrangement, the Fund will take into account the adherence of the Russian

<sup>97</sup>In the four cases in the 1990s for which the Fund granted a waiver, the justifications included that the misreporting had resulted from “a lapse in debt management procedures” (Pakistan), a lack of familiarity “with Fund procedures” (Tajikistan), and an “administrative lapse” (the Philippines). For Ukraine, the Fund granted a waiver in view of “the minor nature of the misreporting and the corrective action taken”; see “Misreporting of Information to the Fund—Policies, Procedures, and Remedies—Preliminary Considerations,” EBS/00/12 (February 2, 2000), pp. 24–27.

<sup>98</sup>Note that misreporting applies only to data a member country is required to report to the Fund. In some of the major crisis cases discussed in earlier chapters (notably Mexico, Thailand, and Korea), data inadequacies made it difficult for the Fund to assess the seriousness of the problems until the crisis erupted. Those shortcomings, however, were not subject to specific reporting requirements, and no sanctions applied.

Federation to the intention communicated in the letter of the Minister of Finance.”<sup>99</sup> In effect, the Fund was putting Russia on probation until it proved it would abide by the rules and by its own commitments.

In 1997, **Ethiopia** failed to disclose a series of transactions in which central bank reserves were diverted to repay a commercial loan. The discovery of those transactions contributed to a decision by the Fund to suspend lending under the existing ESAF arrangement. Again, however, it took no formal disciplinary action.

**Jordan** had an extended arrangement with the IMF in 1996–98 for \$294 million (SDR 200.8 million, or 165 percent of quota). While the arrangement was in effect, the authorities reported positive results to the Fund, indicating the fiscal accounts were stabilizing and economic growth was robust. Toward the end of the program period, in 1998, the staff learned those reports were exaggerated and the program had been much less successful than it had appeared. On that basis, the Fund declined to complete the next review and did not disburse the last \$48 million available under the arrangement.

Management called for a thorough review, carried out in 1999 by John McLenghan, the former Director of the Statistics Department. The Executive Board considered the report in October.<sup>100</sup> The Board took no formal action against Jordan, but the authorities voluntarily made an early repayment of the last drawing they had made in 1998. Some years later, the Fund’s Independent Evaluation Office conducted a further review (Independent Evaluation Office, 2005) and concluded the staff had been negligent in not monitoring the program adequately (including by ignoring conflicting information readily available to the general public).

**Ukraine** was responsible for two episodes of misreporting. In 1995, the authorities told the staff they had fulfilled the prior actions required by the Fund before it would complete the second review under the stand-by arrangement. One of those actions was the clearance of arrears to external creditors. The staff subsequently learned Ukraine had accumulated new arrears to western creditors that it had not revealed at the time. The drawing was ruled to have been “noncomplying” with the terms of the arrangement. However, the Executive Board granted a waiver on the grounds that the amount of arrears was not large and had been cleared before the date of the Board meeting.

In the second episode, Ukraine was found to have tied up \$645 million in foreign exchange reserves in blocked accounts or other commitments. The staff was aware of less than half of those commitments. After further investigation, the staff found the authorities had “consistently” been double counting and otherwise inflating reserves. Although the discrepancies were cleared up before approval of the Extended Fund

<sup>99</sup>Minutes of EBM/99/83 (July 28, 1999), p. 99. For the text of the letter from Kasianov to Camdessus, see “Russian Federation—Staff Report for the 1999 Article IV Consultation and Request for Stand-By Arrangement,” EBS/99/124, Suppl. 3 (July 26, 1999).

<sup>100</sup>See “Jordan—Data Revisions and Information Reporting Issues,” EBS/99/189 (October 1, 1999); and minutes of EBM/99/111 (October 5, 1999).



Facility arrangement in September 1998, the Executive Board took a dim view of both the authorities' "cavalier attitude" and the staff's "willingness to cut corners." The Fund took no formal action, but it did tighten control over the next arrangement.<sup>101</sup>

Ukraine's misreporting became a *cause célèbre* in January 2000, when the British newspaper *Financial Times* reported accusations that the government had been diverting money borrowed from the IMF, using it to speculate in bond markets, and siphoning off profits to personal accounts. The IMF initially denied having any knowledge of these allegations, but it subsequently released details from an external audit, similarly to its response to the Russian case (Catan, 2000).<sup>102</sup>

More generally, by 1999 the staff realized the misreporting problem was serious and growing. Executive Directors and other country officials were increasingly concerned that the Fund lacked the tools to oversee the use of its loans adequately. The requirement in the Articles of Agreement that Fund lending must be conducted under "adequate safeguards" was not being met. In September 1999, the Interim Committee called on the Fund "to perform an authoritative review of its procedures and controls to identify ways to strengthen safeguards on the use of its funds and to report at its next meeting."<sup>103</sup> The staff prepared a set of proposals that were then assessed by an independent panel of experts chaired by Michele Caparelli, the director of internal audit at the European Central Bank.<sup>104</sup>

In March 2000, the Executive Board agreed to implement a number of policy changes. Notably, in future whenever the Fund was considering a request for a lending arrangement, the staff would collect information from the country's central bank to assess whether the bank had adequate "control, reporting, and auditing mechanisms" in place. If not, the Fund would conduct its own safeguards assessments. If misreporting

<sup>101</sup>See "Misreporting of Information to the Fund—Policies, Procedures, and Remedies—Preliminary Considerations," EBS/00/12 (February 2, 2000), p. 26n; and Box 1 in "Ukraine—Ex Post Assessment of Longer-Term Program Engagement," SM/05/379 (October 18, 2005); accessed at <http://www.imf.org/external/pubs/ft/scr/2005/cr05415.pdf>.

<sup>102</sup>The news story quoted an "IMF spokesman" as saying, "I am not aware of any (allegations) regarding Ukraine." Several weeks later, the Fund issued a statement acknowledging that the staff was aware of misreporting as early as August 1998; see "Allegations about the Use of Ukraine's International reserves," NB/00/15, March 14, 2000, p. 4; accessed at <http://www.imf.org/external/np/sec/nb/2000/nb0015.htm>. After a full investigation, the Fund issued an extensive report, "IMF Finds Ukraine National Bank Misreported International Reserves, Considers Circumstances, and Proposes Measures to Prevent Recurrences," NB/00/77, September 6, 2000; accessed at <http://www.imf.org/external/np/sec/nb/2000/nb0077.htm>. The allegation that profits were skimmed off for personal use by senior government officials was made by a former prime minister, Pavlo Lazarenko, who was himself under investigation (and was later convicted in the United States) for money laundering and related offenses.

<sup>103</sup>Paragraph 13 of the Interim Committee communiqué, September 26, 1999; accessed at <http://www.imf.org/external/np/cm/1999/092699A.HTM>.

<sup>104</sup>"Strengthening Safeguards on the Use of Fund Resources," EBS/00/29 (February 24, 2000); and "Strengthening Safeguards on the Use of Fund Resources—Independent Review of IMF Staff Proposals," EBS/00/30 (February 24, 2000).

occurred despite these precautions, the Board agreed the Fund would apply remedial actions more thoroughly and rigorously. Initially, these new procedures were applied experimentally. They were made permanent in 2002.<sup>105</sup>

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<sup>105</sup>The Summing Up of the March 23, 2000, meeting was published as Public Information Notice No. 00/28 (April 4, 2000); accessed at <http://www.imf.org/external/np/sec/pn/2000/pn0028.htm>. For the 2002 revisions, see PR/02/19 (April 5, 2002); accessed at <http://www.imf.org/external/np/sec/pr/2002/pr0219.htm>.