V

Safeguards for IMF Assets

Article I(v) of the IMF Articles of Agreement specifies that one of the purposes of the IMF is "To give confidence to members by making the general resources of the Fund temporarily available to them *under adequate safeguards*…." Moreover, Article V, Section 3*(a)* requires the IMF to "adopt policies…that will *establish adequate safeguards* for the temporary use of the general resources of the Fund" (italics added).

The IMF has established safeguards to protect its currently available and outstanding credit. These safeguards cover six broad elements of IMF operations:

- limits on access to appropriate amounts of financing, with incentives to contain excessively long and heavy use;
- conditionality and program design;
- safeguards assessments of central banks;
- post-program monitoring;
- measures to deal with misreporting; and
- various voluntary services of the IMF, such as technical assistance; the transparency initiative, including the establishment and monitoring of codes and standards, particularly, monetary and fiscal transparency and the assessment of financial sector soundness; and the governance initiative.

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

Safeguards put in place to deal with overdue obligations to the IMF include the following two broad areas:

- Policies to assist members in clearing arrears to the IMF, including:
  - —the cooperative arrears strategy, consisting of three components: prevention of arrears, collaboration in clearing arrears, and remedial

measures, which are intended to have a deterrent effect for countries that do not cooperate actively; and

— the rights approach, which allows a member in arrears to accumulate "rights" to future disbursements from the IMF.

- Measures to protect the IMF's financial position.

The remainder of this chapter expands upon the role and content of these various safeguards for IMF resources.

Safeguarding Available and Outstanding Credit

Limiting Access and Providing Appropriate Incentives

The first safeguard to ensure the temporary and appropriate use of IMF resources is the IMF's policies regarding access under the credit tranches and various lending facilities in the GRA, and to its concessional assistance under the PRGF and PRGF-HIPC Trusts. Access policy in the GRA is discussed in Chapter II, along with the measures that have been adopted to discourage excessively large or prolonged use of IMF resources. To limit unduly large use of IMF resources, surcharges are imposed on credit outstanding above a threshold level. Prolonged use of IMF resources is addressed through time-based repurchase expectations, which come into force before the standard repurchase obligations (see Table II.2).

Access policies for concessional IMF assistance are discussed in Chapter IV.

Conditionality and Program Design

Once the level of access has been determined, conditionality is the next line of defense in safeguarding IMF resources. Conditionality comprises an evolving set of guidelines covering the economic policies that members intend to follow as a condition for the use of IMF resources. The key objective of conditionality is to ensure that members drawing on the IMF adopt adequate policies to cope with their balance of payments problems and enable them to repay the IMF within the designated repurchase period. At the same time, conditionality is designed to give confidence to members that IMF resources will continue to be available to them if the terms of the associated arrangement are met.

Conditionality operates through a number of instruments:

- Members formally request an arrangement with the IMF through a Letter of Intent. This document describes the economic program to be supported by IMF resources and may be accompanied by a more detailed Memorandum of Economic and Financial Policies.

- All arrangements in the upper credit tranches and under the EFF feature phased purchases. This reflects the strong link that is established between IMF financing and policy adjustment. Most arrangements incorporate an even phasing of purchases, but where adjustment is concentrated at the beginning of an arrangement, purchases can be front-loaded.
- The second and any subsequent purchases after approval of the arrangement are normally contingent on the observance of performance criteria. These are intended to cover the crucial objectives of the adjustment program that are under the control of the authorities, such as management of international reserves, monetary policy, fiscal policy, external debt, and structural reforms where these are considered essential. All arrangements additionally include a number of standard performance clauses prohibiting the introduction or intensification of exchange and trade restrictions and the accumulation of external payments arrears.
- Some purchases under arrangements are conditional on completion of scheduled program reviews. These allow for the assessment of progress on policies that cannot easily be quantified or defined in performance criteria. If a program review is delayed and slips past a subsequent test date, the later performance criteria become applicable.
- A member may be expected to implement some corrective measures before an arrangement is approved, a program review is completed, or a waiver of a performance criterion is granted. These prior actions are specific measures whose implementation is both readily verifiable and subject to a realistic timetable.

The design of adjustment programs is critical in keeping an arrangement on track to meet performance criteria and complete program reviews. There is no single model of adjustment that is applied indiscriminately to all members; members design their own programs, in close consultation with IMF staff. All adjustment programs supported by the IMF nevertheless share a common objective: to achieve a current account position that is sustainable by normal capital flows without resort to restrictions that would be harmful to the member or other members.

Conditionality has evolved substantially over the years. Until the 1980s, policy conditions were primarily limited to macroeconomic variables, such as those related to domestic credit creation and the fiscal deficit. Starting in the late 1980s, however, there was a broadening of the scope of conditionality. In part, this reflected the increasing emphasis on growth as an objective of IMF-supported programs, together with the growing involvement of the IMF with members where severe structural problems were impeding the achievement of a sustainable balance of payments position. As a result, IMF conditionality expanded to encompass structural reforms, including those intended to strengthen fiscal institutions, build a sound financial sector, and increase the efficiency of the economy more generally.

The expansion of conditionality has raised a number of issues. In particular, it has created concerns that excessively broad and detailed conditionality may undermine national ownership of policy programs, which is essential for successful program implementation. Moreover, extensive conditionality may strain the member's administrative capacity, thus undermining implementation of those policies that are truly essential. The IMF is therefore in the midst of an effort to streamline and focus its conditionality. Pending the completion of that review, conditionality in new and existing IMF arrangements is subject to an "Interim Guidance Note on Streamlining Structural Conditionality."[1]

Safeguards Assessments of Central Banks

Background

In March 2000, the Executive Board adopted a strengthened framework of measures to safeguard the use of IMF resources through the introduction of safeguards assessments of central banks. The framework was developed in the wake of instances of misreporting and allegations of misuse of IMF resources. Revised guidelines on misreporting were put in place (see below), and safeguards assessments were adopted as an ex ante mechanism to help prevent the misreporting of information and possible misuse of IMF resources.

The specific objective of safeguards assessments is to provide reasonable assurance to the IMF that a central bank's control, accounting, reporting, and auditing systems in place to manage resources are adequate to ensure the integrity of operations. Central bank practices and procedures are reviewed because central banks are in most cases the recipients and guard-

[1]See "Interim Guidance Note on Streamlining Structural Conditionality" (http://www.imf.org/external/np/pdr/cond/2001/eng/091800.pdf).

ians of IMF disbursements to members in their roles as the member's fiscal agent and depository for the IMF.

Safeguards assessments apply to all members with arrangements for use of IMF resources approved after June 30, 2000. Member countries with arrangements in effect prior to June 30, 2000 are subject to transitional procedures. These countries are required to demonstrate the adequacy of only one key element of the safeguards framework, namely that their central banks publish annual financial statements that are audited by external auditors in accordance with internationally accepted standards.[2] The focus is on the external audit because it provides a foundation for the provision of reliable financial information, and is considered an essential component of a central bank's overall governance structure.

Conceptual Framework

Safeguards assessments consider the adequacy of five key areas of control and governance within a central bank (Box V.1). These five areas can be summarized under the acronym ELRIC, as follows:

- **E**xternal audit mechanism,
- **L**egal structure and independence,
- financial **R**eporting,
- **I**nternal audit mechanism, and
- system of internal **C**ontrols.

The ELRIC framework is derived from the IMF's "Code of Good Practices on Transparency in Monetary and Financial Polices" and employs International Accounting Standards (IAS), International Standards on Auditing (ISA), and the IMF's data dissemination standards (the Special Data Dissemination Standard (SDDS) and the General Data Dissemination System (GDDS)) as benchmarks (see below). In the area of the legal structure and independence, there is no generally accepted benchmark for central bank independence and legal structure. The framework, therefore, calls for the identification in the legislation governing the central bank of any provision that could allow for undue interference with central bank operations by outside parties, that could jeopardize the central bank's governance

[2]The term "external auditor" is used to distinguish the external audit of the financial statements from the activities of the internal audit department that is typically part of a central bank. The external auditor, usually an accounting firm or a supreme audit institution, is expected to be independent of the central bank.

Box V.1. Safeguards Assessments of Central Banks

The five key areas of the formal safeguards assessments framework are as follows:

- ***E**xternal Audit Mechanism.* The external audit mechanism comprises the practices and procedures in place to enable an independent auditor to express an opinion as to whether the financial statements are prepared, in all material respects, in accordance with an established financial reporting framework. An external audit mechanism is important for the credibility of a central bank; the objective of the assessment is to establish whether an independent and high-quality external audit of the central bank's financial statements is conducted regularly and whether previous recommendations made by the auditors have been implemented. The assessment also ascertains whether an audit opinion is published with the financial statements.
- *The **L**egal Structure and Independence.* Government interference with central bank operations can undermine a central bank's autonomy and increase the risks to which it is exposed, particularly if agencies other than the central bank have responsibility for reserves management. The objective in assessing this area is to ensure that (1) the arrangements whereby the central bank extends credits, advances, or overdrafts to the government follow legal procedures, and that the government has not interfered with these regulations; and (2) for those agencies that share monetary authority with the central bank, the legal basis of their relationship to the central bank, their role as a monetary authority, and the responsibility for reserves management are transparent and explicit.
- *Financial **R**eporting.* Adequate financial reporting practices are an essential element of effective central bank operations and encompass the provision of both internal information (including financial, operational, and compliance data) and external market information about events and conditions that support decision making. For such information to be useful it must be relevant, reliable, timely, accessible, and provided in a consistent format. The objective in assessing financial reporting practices is to ensure that the central bank adheres to international good practices in its accounting principles, financial statement presentation and disclosures, coverage of operations, and reporting of statistical data. Nonadherence to accepted good practices might be an indicator of a lack of transparency and accountability.
- ***I**nternal Audit Mechanism.* Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluating and improving the effectiveness of its risk management, control, and governance processes. The objective in assessing the internal audit function at a central bank is to evaluate its effectiveness by considering the organizational independence and objectivity that allows

the internal audit activity to fulfill the nature and scope of its work program and the procedures for communicating results unencumbered from external interference.

- *System of Internal Controls.* Internal control is a process comprising all the policies and procedures effected by the board, management, and other personnel of a central bank to assist in achieving (1) the effective and efficient conduct of its business; (2) its compliance with applicable laws, regulations, policies, plans, and internal rules and procedures; and (3) the timely preparation of reliable financial information. A system of effective internal controls is a critical component for the sound operation of central bank activities, including the safeguarding of assets, the prevention and detection of fraud and error, and the accuracy and completeness of accounting records. The objective in assessing internal control systems is to determine whether appropriate procedures are in place, at all levels, to provide reasonable assurance that material risks that could adversely affect the central bank's operations are being continuously recognized, assessed, and mitigated. The main focus is on controls over the banking, accounting, and foreign exchange operations of the central bank.

structure in any way, or that gives monetary or reserves management authority to an entity other than the central bank.

In order to ensure a reasonable degree of consistency across countries, IMF staff has developed standardized analytical techniques and assessment tools for each element of ELRIC. At the same time, in applying the benchmarks, due consideration is given to the country's degree of economic development and to its central bank's complexity of operations. Such flexibility in the assessment framework is considered necessary to allow for a variety of appropriate remedial actions, ranging from long-term technical assistance to the possibility of prior actions before further disbursements by the IMF.

Modalities

The IMF Treasurer's Department takes the lead in implementing safeguards assessments, which are undertaken in two stages:

Stage One is a preliminary assessment of the adequacy of the central bank's ELRIC based on a review of documentation provided by the authorities and, if necessary, discussions with the external auditors. Vulnerabilities identified during a Stage One assessment are documented, together with judgment about whether or not a Stage Two on-site assessment is necessary.

In cases where a Stage Two assessment is not considered necessary, but vulnerabilities are nonetheless identified, the staff recommends remedial actions that, if endorsed by management, are discussed with country authorities and presented to the Executive Board in conjunction with other IMF program issues.

Stage Two on-site assessment missions confirm or modify the preliminary conclusions drawn by the Stage One assessment and propose specific remedial measures to alleviate confirmed vulnerabilities in a central bank's ELRIC. The remedial actions are discussed with central bank officials and incorporated into the member's program of reforms.

The modalities for transitional procedures that are applicable to countries with IMF arrangements in effect prior to June 30, 2000 are similar to a Stage One assessment. Central banks whose financial statements are presently not audited by external auditors are expected to commit at the next program review to implement an acceptable external audit mechanism under an agreed-upon timetable. For central banks that have an external audit mechanism and vulnerabilities are identified, staff recommends specific remedial actions in the same manner as for Stage One assessments.

Post-Program Monitoring

While the above safeguards focus on the identification and reduction of risks before or during the disbursement of IMF resources, post-program monitoring takes place after the disbursement phase. Post-program monitoring provides for closer monitoring of the circumstances and policies of members that have substantial IMF credit outstanding following the expiration of their IMF arrangements. Introduced in 2000 during the review of IMF facilities, post-program monitoring formalizes the long-standing consultation provisions included in all IMF arrangements. A guidance note on the implementation of post-program monitoring is available on the IMF's website.[3]

The aim of post-program monitoring is to identify and address risks at an early stage. Such monitoring is intended to provide an early warning of policies that could call into question a member's continued progress toward external viability, and thus could eventually imperil IMF resources. It also serves as a mechanism for bringing these issues to the attention of the authorities and the Executive Board and for stimulating action to improve the situa-

[3]"Review of Fund Facilities: Proposed Decisions and Implementation Guidelines" (November 2, 2000). See http://www.imf.org/external/np/pdr/fac/2000/02/index.htm.

tion. A Public Information Notice (PIN) and the associated staff report are published on a voluntary basis following Executive Board consideration.

Measures to Deal with Misreporting

Background

The IMF needs reliable information for every aspect of its work, and it is particularly important in ensuring that its resources are used for their intended purposes. While known incidents of misreporting and misuse of the IMF's resources have been rare, it is important to the integrity of the IMF's reputation as a prudent provider of financial assistance to respond quickly and effectively to any allegations of misreporting or misuse of its resources. Unlike project-related loans, IMF disbursements are typically added to a country's gross international reserves for general use by the country. As a result, the fungibility of resources, both domestic and foreign, makes it extremely difficult, if not impossible, to track the specific uses of reserves.

The term misreporting is used broadly to cover situations in which a member provides incorrect information to the IMF. It is often difficult to establish the reason why information was misreported, but several factors have arisen, including administrative lapses, weaknesses in statistical capacity, inherent subjectivity of certain data, negligence, and deliberate misrepresentation.

The IMF has developed a set of guidelines or rules that govern misreporting in the context of a member's provision of information under an IMF-supported economic program. The guidelines apply whenever a member makes a purchase or receives a disbursement from the IMF on the basis of inaccurate information. The guidelines cover all IMF lending facilities, including emergency assistance and the CFF, but not HIPC assistance at present. The guidelines apply regardless of the reason for misreporting and establish a limitation period of four years over which the IMF can take action.

Misreporting can also arise under the IMF's Articles in the context of the general obligation of all members, irrespective of whether or not they have used IMF resources, to provide the IMF with relevant economic information. Article VIII, Section 5 specifies members' continuing obligation to provide the IMF with the information the IMF deems necessary for its activities. In addition to the specific data listed in the Articles, members are also required to provide any additional information requested by the Managing Director or required in Executive Board decisions. Members must provide all information "in as detailed and accurate a manner as is practicable and, so far as possible, to avoid mere estimates."

Procedures and Remedies

Whenever evidence indicates that misreporting may have occurred, the Managing Director consults with the member and submits a report to the Executive Board together with a recommendation for the course of action to be taken by the Board. A member found to have breached Article VIII, Section 5 may be subject to the remedial measures specified in the Articles for a breach of obligation, including the possibility of a declaration of ineligibility to draw on IMF resources. In determining whether a member has breached its obligations under Article VIII, Section 5, the Executive Board must take into account the member's capacity to produce the relevant information.

Under the misreporting guidelines, a member found to have obtained the use of IMF resources on the basis of information that proves to be incorrect is deemed to have made a noncomplying purchase. The member is required to repay the IMF normally within 30 days, unless the Executive Board grants a waiver. Waivers can be granted if the deviations are minor or temporary, or the member has taken additional policy measures appropriate to achieve the objectives of the economic program. Failure to meet the repayment expectation will result in suspension of further purchases or disbursements under an existing arrangement and could trigger action to declare the member ineligible to draw on IMF resources. Interest may be charged on the amount subject to repayment expectation at the rate applicable to overdue amounts.

Publication of Misreporting Cases

After the Executive Board has made its determination about misreporting, the IMF makes public relevant information for each case of misreporting. Publication is automatic, but reviewed by the Executive Board on a case-by-case basis. The public statement is appropriately calibrated to the circumstances of the case and takes into account the seriousness of the misreporting, remedial measures taken, and other relevant considerations.

Voluntary Safeguards

The main objective of IMF technical assistance is to contribute to the development of the productive resources of member countries by enhancing the effectiveness of economic policy and financial management.[4] The IMF seeks to achieve this objective in two ways:

[4]For more information, see "Policy Statement on IMF Technical Assistance," issued on April 1, 2001 (see http://www.imf.org/external/pubs/ft/psta/index.htm).

- by supporting the efforts of members to strengthen their capacity—in both human and institutional resources—to formulate and implement sustainable, growth-oriented, and poverty-reducing macroeconomic, financial, and structural policies; and
- by assisting countries in the design of appropriate macroeconomic and structural policy reforms, taking account of the lessons learned by other countries in addressing similar economic policy reforms.

As the IMF seeks to strengthen recipient country ownership, its technical assistance program is based on the fundamental principle that to be effective and to have a high impact, it is important to ensure that a partner country is fully committed to owning the work associated with the assistance and implementing the recommendations flowing from the technical assistance.

Regarding other voluntary safeguards, the IMF has responded to calls for increased transparency for all members through a number of initiatives on the interrelated issues of codes and best practices. These initiatives are part of the broader effort to improve the architecture of the international financial system. The concept of internationally agreed standards is not new: for many years standards have provided a context within which policy advice and technical assistance have been provided to national authorities. The IMF, along with other multilateral institutions, has launched a series of transparency initiatives focusing on assessments of four main internationally recognized standards. These are:[5]

- the Special Data Dissemination Standard (SDDS),
- the Basel Core Principles,

[5]The SDDS (http://www.dsbb.imf.org/sddsindex.htm) is a standard of good practices in the dissemination of economic and financial data to which IMF member countries may subscribe on a voluntary basis. It is intended for use mainly by countries that either have or seek access to international financial markets, to signal their commitment to the provision of timely and comprehensive data. The "Basel Core Principles for Effective Banking Supervision" (http://www.bis.org) are intended to serve as a basic reference for supervisory and other public authorities within their jurisdictions. "The Code of Good Practices on Fiscal Transparency" (http://www.imf.org/external/np/fad/trans/code.htm) aims at leading to a better-informed public debate about the design and results of fiscal policy, making governments more accountable for the implementation of fiscal policy, and thereby strengthening credibility and public understanding of macroeconomic policies and choices. The "Code of Good Practices on Transparency in Monetary and Financial Policies" (http://www.imf.org/external/np/mae/mft/index.htm) is a guide for members to assess the degree of transparency in their institutional and operational frameworks for monetary and financial policies.

- the fiscal transparency code, and
- the monetary and financial transparency code.

The SDDS, principles, and codes are generally accepted as benchmarks of good practices on a voluntary basis. The IMF and World Bank have collaborated closely to assess progress in implementing selected standards. These summary assessments are referred to as "Reports on the Observance of Standards and Codes" (ROSCs), and a large number of them have been posted on the IMF's website on a voluntary basis by the member countries involved. In this context, the joint IMF–World Bank Financial Sector Assessment Program (FSAP) has undertaken a number of assessments of the stability of countries' financial system.[6] More recently, the IMF has also been addressing issues of best practice in the related areas of foreign reserves management and the development of macroprudential indicators.[7]

In 1997, following a discussion on the role of the IMF in governance issues, the IMF Executive Board approved a "Guidance Note on Governance."[8] The note was prepared in recognition of the importance of good governance for macroeconomic stability and sustained noninflationary growth, the promotion of which forms part of the IMF's mandate. Its central message was a call for greater attention by the IMF to issues of governance, in particular through:

- a more comprehensive treatment in the context of both Article IV consultations and IMF-supported programs of those governance issues that are within the IMF's mandate and expertise;
- a more proactive approach in advocating policies and the development of institutions and administrative systems that eliminate the opportunity for rent-seeking, corruption, and fraudulent activity in the management of public resources;
- an evenhanded treatment of governance issues in all member countries; and
- enhanced collaboration with other multilateral institutions, in particular the World Bank, to make better use of complementary areas of expertise.

[6]The Financial System Stability Assessments under the FSAP reflect the Monetary and Financial Transparency Code and address systemic vulnerability issues in the financial system (http://www.imf.org/external/np/fsap).

[7]See IMF and World Bank, "Assessing the Implementation of Standards: A Review of Experience and Next Steps," January 11, 2001 (http://www.imf.org/external/np/pdr/sac/2001/eng/review.htm).

[8]See "The Role of the Fund in Governance Issues—Guidance Note," July 27, 1997 (http://www.imf.org/external/np/sec/nb/1997/nb9715.htm).

In cases where a governance issue with a macroeconomic impact lies outside the IMF's primary responsibilities, the IMF collaborates with other multilateral organizations possessing the appropriate expertise. In February 2001, the Executive Board reviewed the experience to date with the IMF's role in governance issues.[9]

Dealing with Overdue Financial Obligations

Overview

The IMF's experience with the timeliness of members in meeting their financial obligations was from the outset generally satisfactory. However, beginning in the early 1980s, partly because of the sharp increase in international interest rates, late payments to the IMF rose significantly in both frequency and amount. While most delays were corrected within a short period of time, the emergence of more protracted arrears raised serious concern and highlighted the need to develop more systematic procedures for dealing with arrears.

In the late 1980s and the early 1990s, the IMF strengthened its procedures for dealing with overdue obligations by adopting various measures, including IMF-monitored programs and informal staff monitoring—neither with financing—and the rights approach to help members in arrears establish a track record of cooperation with the IMF and eventually clear their arrears to the IMF. This process culminated in the adoption of the three-pronged cooperative strategy for handling arrears that emphasizes prevention of arrears, collaboration in clearing arrears, and remedial measures against continuing arrears in cases where active cooperation is lacking. The rights approach to arrears clearance is an integral part of the cooperative strategy.

The cooperative strategy has been broadly successful in preventing new cases of protracted arrears (defined as arrears outstanding for more than six months) from emerging and helping to resolve the cases of long-overdue payments that existed at end of the 1980s.[10] Of the 11 cases of protracted arrears at end-1989, 8 had been resolved by the mid-1990s, and only 3 cases of protracted arrears emerged during the 1990s. At end-April 2001, of the 6

[9]See "Review of the Fund's Experience in Governance Issues," March 28, 2001 (http://www.imf.org/external/np/gov/2001/eng/report.htm).

[10]As the arrears strategy was strengthened in 1989, the current strategy is often called the strengthened cooperative strategy.

countries with protracted arrears to the IMF, most have experienced, or continue to experience, domestic conflicts, or international sanctions, or both.[11]

The level of outstanding arrears to the IMF has also declined over the last decade, from SDR 3.1 billion at end-1989 to SDR 2.2 billion at end-April 2001 (Figure V.1 and Figure V. 2). More than 80 percent of the arrears at end-April 2001 were obligations due to the GRA, with the balance due to the SDR Department, the Trust Fund, and SAF, all about evenly divided between overdue principal and overdue charges and interest payments. Arrears of the Democratic Republic of the Congo, Liberia, Somalia, and Sudan accounted for more than 95 percent of total overdue financial obligations to the IMF (Table V.1).

The Cooperative Strategy

Prevention

Prevention is the IMF's primary safeguard against the emergence of new cases of arrears, as discussed earlier. Preventive measures include IMF surveillance of members' economic policies, policy conditionality attached to the use of IMF resources, technical assistance by the IMF in support of members' adjustment and reform efforts, and the assurance of adequate balance of payments financing for members under IMF-supported programs.

In addition, the IMF has strengthened surveillance with the aim of improving its ability to identify emerging economic and financial difficulties in member countries. While these measures to strengthen the international financial architecture are not part of the IMF's cooperative strategy on arrears, they do have an indirect effect of limiting the need for IMF resources and thereby the emergence of arrears. In this area, greater attention has been given to members' timely provision of key economic and financial information, and a discussion of data availability and quality is required in relevant country reports. In view of the importance of the soundness of the banking system, the IMF has also taken steps to strengthen financial sector surveillance, focusing on members' financial and external vulnerability to crises. These efforts have been supplemented by debt sustainability analyses in cases of heavily indebted members, which identify the need for adjustment policies, debt relief, and other exceptional financial

[11]The Islamic State of Afghanistan, the Democratic Republic of the Congo, Iraq, Liberia, Somalia, and Sudan.

FIGURE V.1. OVERDUE FINANCIAL OBLIGATIONS TO THE IMF, JANUARY 1990–APRIL 2001

(In millions of SDRs)

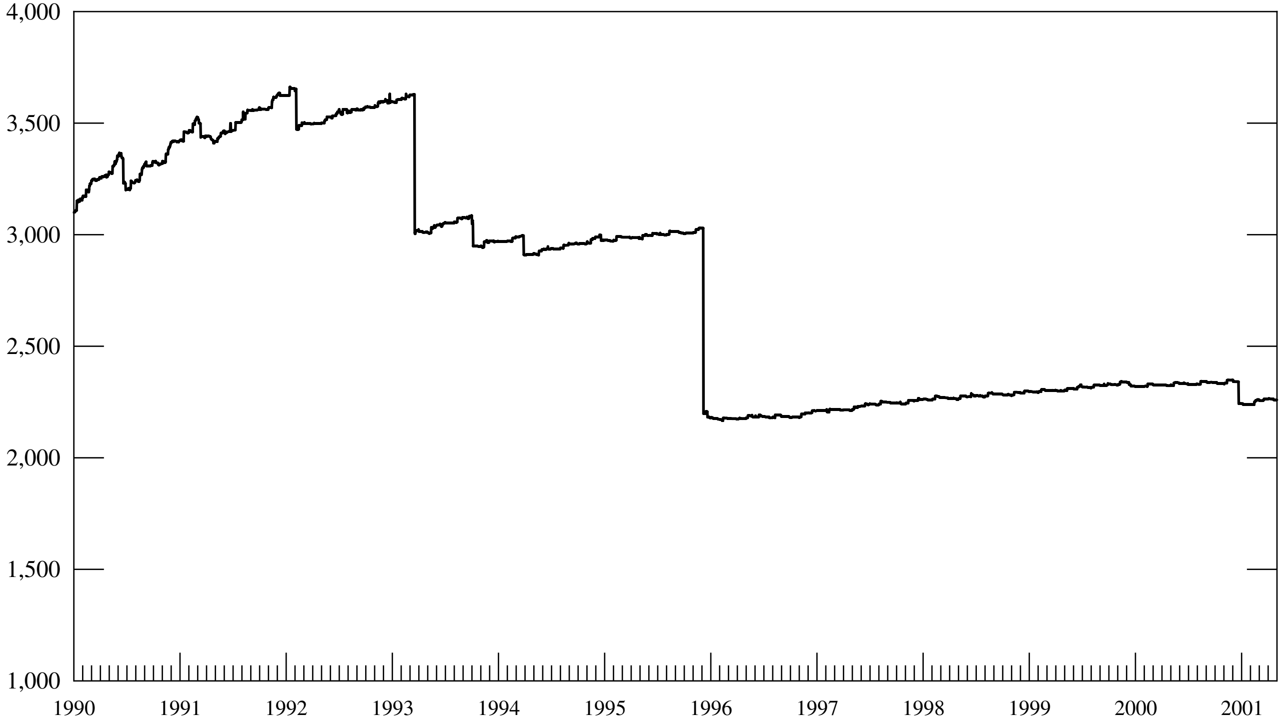

FIGURE V.2. IMF CREDIT OUTSTANDING AND OVERDUE REPURCHASES, 1990–APRIL 2001

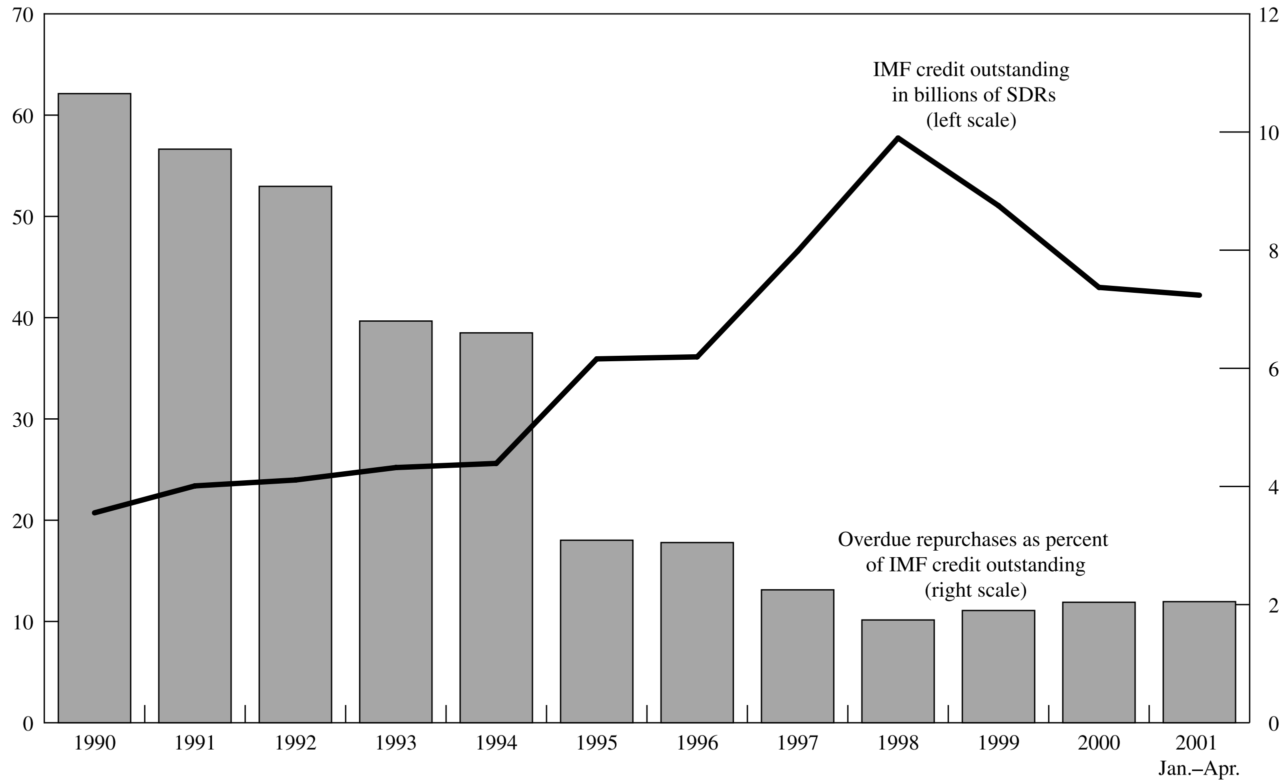

TABLE V.1. ARREARS TO THE IMF OF COUNTRIES WITH OBLIGATIONS OVERDUE FOR SIX MONTHS OR MORE, BY TYPE AND DURATION, AS OF APRIL 30, 2001

(In millions of SDRs)

		By Type			By Duration			
	Total	General Department (Including SAF)	SDR Department	Trust Fund	Less than one year	1–2 years	2–3 years	3 years or more
Afghanistan, Islamic State of	6.2	—	6.2	—	1.4	1.1	1.2	2.5
Congo, Democratic Republic of the	391.8	375.7	16.1	—	13.3	19.2	27.8	331.5
Iraq	45.9	—	45.9	—	5.0	3.8	4.2	33.0
Liberia	484.8	433.5	21.2	30.1	12.8	9.7	10.6	451.7
Somalia	209.6	193.1	8.7	7.8	6.2	4.7	5.2	193.5
Sudan	1,103.2	1,025.1	0.1	78.0	23.7	19.5	22.9	1,037.0
Total	2,241.5	2,027.4	98.2	115.9	62.4	58.0	71.9	2,049.2

Note: Numbers may not add to totals due to rounding.

assistance to help achieve sustainable economic growth and durable poverty reduction.

Collaboration

The collaborative element of the arrears strategy provides a framework for cooperating members in arrears to establish a strong track record of policy performance and payments to the IMF and, in turn, to mobilize bilateral and multilateral financial support for their adjustment efforts and to clear arrears to the IMF and other creditors. Pursuit of the collaborative approach, including the use of the rights approach, has played an important role in resolving the protracted arrears of a number of members and contributed to the improved policy and payments performance in some of the current protracted arrears cases.

Established in 1990, the rights approach permits a member to establish a track record on policies and payments to the IMF under a rights accumulation program (RAP) and to earn "rights" to obtain IMF resources under successor arrangements following the completion of the program and settlement of the arrears to the IMF. Eligibility for the rights approach is limited to the 11 members in protracted arrears to the IMF at the end of 1989.[12] The rights approach facilitated the clearance of arrears and normalization of financial relations with Peru (1993), Sierra Leone (1994), and Zambia (1995), and remains available to Liberia, Somalia, and Sudan.[13]

Programs supported by the rights approach involve upper credit tranche conditionality and require modified financing assurances.[14] Under these programs, members are expected to adopt and implement strong adjustment programs that establish a credible track record of policy implementation and help create the conditions for sustained growth and substantial progress toward

[12]These were Cambodia, Guyana, Honduras, Liberia, Panama, Peru, Sierra Leone, Somalia, Sudan, Vietnam, and Zambia.

[13]To provide reassurance to lenders to the PRGF Trust that they would be repaid for PRGF (formerly ESAF) loans made to encash rights under the RAP, the IMF in 1993 pledged to sell up to 3 million ounces of gold if it were determined that the PRGF Reserve Account, plus other available means of financing, were insufficient to meet payments due to creditors. For a discussion of the gold pledge, see Chapter II.

[14]Financing assurances were modified from the usual IMF arrangements in the sense that arrears to the IMF (and possibly other multilateral institutions) could continue to be outstanding during the program period, although it is expected that the member will make maximum efforts to reduce its overdue obligations to the IMF.

external viability. Such programs should adhere to the macroeconomic and structural policy standards associated with programs supported under the EFF or PRGF. To support the member's adjustment efforts, adequate external financing is required for the program, including debt rescheduling and relief from bilateral and private creditors and new financing from various sources. Under rights accumulation programs (RAPs), members are expected, at a minimum, to remain current with the IMF and the World Bank on obligations falling due during the period of the program. RAPs are normally of a three-year duration, although flexibility to tailor the length of the agreed track record to the member's specific circumstances can be provided.[15]

As part of the collaborative approach, the IMF has also developed other measures, including IMF- and staff-monitored programs to help members in arrears establish a track record on policies and payments leading to eventual clearance of arrears to the IMF. These programs, supported by the provision of technical assistance from the IMF, have been instrumental in assisting these members in the design and implementation of appropriate economic policies and making progress toward normalization of financial relations with external creditors, including the IMF.

Over the past several years, the IMF's Executive Board has discussed on a number of occasions IMF assistance to post-conflict countries, including those with protracted arrears to the IMF.[16] Executive Directors noted the special challenges posed by the presence of large protracted arrears in these countries, and agreed that the IMF's arrears strategy provides adequate flexibility to address effectively the range of circumstances in these countries. To ensure a well-coordinated response to the special problems associated with arrears clearance, Executive Directors agreed that World Bank and IMF staff would prepare an arrears clearance plan with the member, in consultation with each other and other major creditors, once a post-conflict country with arrears had made adequate progress in restoring macroeconomic stability and re-establishing relations with the international community. Executive Directors also agreed that the IMF should consider relaxing its calls for payments to the IMF as a test of cooperation in post-conflict cases, provided the

[15]The length of the RAPs of the three countries that have made use of the rights approach was 1½ years for Peru, 1¾ years for Sierra Leone, and 3 years for Zambia.

[16]For a general discussion of post-conflict assistance beyond the arrears context, see Chapter II.

Box V.2. Measures for Deterrence of Overdue Financial Obligations to the IMF: Timetable of Procedures

Time After Emergence of Arrears	Action
Immediately	• Staff sends a cable urging the member to make payment promptly; this communication is followed up through the office of the concerned Executive Director. • The member is not permitted any use of the IMF's resources nor is any request for the use of IMF resources placed before the Executive Board until the arrears are cleared.
2 weeks	• Management sends a communication to the Governor for the member stressing the seriousness of the failure to meet obligations and urging full and prompt settlement.
1 month	• The Managing Director notifies the Executive Board that an obligation is overdue.
6 weeks	• The Managing Director notifies the member that unless the overdue obligations are settled promptly a complaint will be issued to the Executive Board. • The Managing Director consults with and recommends to the Executive Board that a communication concerning the member's situation be sent to selected IMF Governors or to all IMF Governors in the event that the member has not improved its cooperation with the IMF.
2 months	• A complaint regarding the member's overdue obligations is issued by the Managing Director to the Executive Board.
3 months	• The complaint is given substantive consideration by the Executive Board. The Board has usually decided to limit the member's use of the IMF's general resources and if overdue SDR obligations are involved, suspend its right to use SDRs.

6–12 months	• The Executive Board reviews its decision on limitation within 3 months, with the possibility of a second review if warranted. • Depending on the Executive Board's assessment of the specific circumstances and of the efforts being made by the member, a declaration of ineligibility is considered to take effect within 12 months after the emergence of arrears. • Communications are sent to all IMF Governors and the heads of selected international financial institutions regarding the member's continued failure to fulfill its financial obligations to the IMF at the same time as the declaration of ineligibility is considered.
Up to 15 months	• A declaration of noncooperation is considered within 3 months after the dispatch of the preceding communications.
Up to 18 months	• A decision on suspension of voting and representation rights is considered within 3 months after a declaration of noncooperation.
Up to 24 months	• The procedure on compulsory withdrawal is initiated within 6 months after a decision on suspension.

member is judged to be cooperating on policies and that all other multilateral creditors take comparable action.

Remedial Measures

Remedial measures, which are essentially sanctions, are the final component of the arrears strategy applied to member countries with overdue obligations that do not actively cooperate with the IMF in seeking a solution to their arrears problems, under an escalating time schedule (Box V.2 above)

This timetable guides Executive Board consideration of sanctions of increasing intensity, although the application of each particular step is considered in light of the individual circumstances of the member concerned. In cases where civil conflicts, the absence of a functioning government, or international sanctions have prevented the IMF from reaching a judgment regarding the member's cooperation, the application of these measures has been delayed or suspended until such a judgment can be reached.

A number of remedial measures have been applied against countries that remain in protracted arrears to the IMF. As of end-2000, the Islamic State of Afghanistan, the Democratic Republic of the Congo, Iraq, Liberia, Somalia, and Sudan remained ineligible to use the general resources of the IMF. Declarations of noncooperation were in effect for the Democratic Republic of the Congo (issued on February 14, 1992) and Liberia (issued on March 30, 1990). In addition, the voting rights of the Democratic Republic of the Congo remained suspended (effective June 2, 1994).

To further strengthen incentives for members in protracted arrears to cooperate with the IMF in solving their arrears problems, the Executive Board in 1999 established understandings regarding the de-escalation of remedial measures. The de-escalation process recognizes the efforts of a member to strengthen economic policies and establish a solid record of policy performance and payments to the IMF, with the ultimate objective of full clearance of arrears to the IMF. Under this process, the suspension of Sudan's voting rights in the IMF put in place in August 1993 was lifted in August 2000.

Protecting the IMF's Financial Position

Historically, the IMF accumulated reserves to protect against the risk of administrative deficits and capital loss. When overdue financial obligations became significant in the early 1980s, the IMF's income began to be affected. To avoid an overstatement of actual income, the Executive Board decided in March 1985 that charges due but not settled from members in arrears to the IMF for six months or more were to be reported as deferred, rather than current, income. Since that time, charges accrued from those members and not paid are excluded from income unless the member becomes current in paying its charges. Since May 1986, the financial consequences of overdue obligations to the IMF have, to the extent possible, been shared equally between debtor and creditor member countries (see Chapter II, Box II.9). Under the burden-sharing mechanism, the rate of charge is increased and the rate of remuneration reduced to generate sufficient resources to offset the income lost through the deferral of charges.[17] When deferred charges are settled by members clearing protracted arrears, equivalent amounts are distributed to members that previously paid higher charges or received reduced remuneration.

The IMF levies special charges on overdue repurchases or repayments. For overdue obligations to the GRA, special charges apply only to arrears of less than six months duration.[18] The special rate of charge on overdue repurchases is set equal to the positive margin between the SDR interest rate and the basic rate of charge. As the basic rate of charge has exceeded the SDR interest rate since May 1993, this margin has been zero and the normal rate of charge has been levied on overdue repurchases. The special charge on overdue charges, levied for six months in the GRA, is set equal to the SDR interest rate.[19] Overdue repayments or interest to the PRGF Trust are charged interest at the SDR interest rate instead of the usual concessional rate of ½ of 1 percent on PRGF loans.[20]

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[17]There are, however, limits on the potential adjustment to the rate of remuneration. The average rate of remuneration for an adjustment period cannot be reduced to less than 85 percent of the SDR interest rate for the purpose of generating resources to offset deferred charges and contributing to the SCA-1, unless the Executive Board so decides. In any case, under the IMF's Articles the rate of remuneration cannot fall to less than 80 percent of the SDR interest rate.

[18]Special charges are limited to members with arrears of less than six months because it is thought that, while these charges may provide an incentive to settle obligations due, in the long run they may add to the problem of members' overdue obligations, making eventual arrears clearance more difficult. The same considerations lie behind the decision not to levy any special charges on charges overdue for six months or longer.

[19]The short duration of the levy of special charges on overdue charges significantly reduces interest compounding on overdue obligations.

[20]Overdue SAF and ESAF obligations are charged interest at the SDR interest rate less ½ of 1 percent, divided by two.