



IFAD
INTERNATIONAL FUND FOR AGRICULTURAL DEVELOPMENT
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**REVIEW OF THE IMPLEMENTATION OF IFAD'S POLICY FRAMEWORK FOR
MANAGING PARTNERSHIPS WITH COUNTRIES IN ARREARS**

Introduction

1. The IFAD Policy Framework for Managing Partnerships with Countries in Arrears was approved by the Governing Council at its Twenty-First Session in February 1998 (document GC 21/L.7) and adopted in its Resolution 106/XXI. It provides a framework for settling arrears using the original net present value (NPV) of the loan. Under this policy, IFAD is permitted to negotiate arrears settlement packages with borrowing countries, while ensuring that the settlement maintains the original NPV.

2. The present document provides a brief overview of the action taken by IFAD to address the arrears problems of a number of countries. It highlights the practical difficulties that have arisen in implementing the current NPV policy, particularly for countries with loans on highly concessional terms – where non-payment of arrears is due to extreme financial difficulties – but also for some countries qualified for other lending terms and having long-standing arrears. The purpose of this document is to suggest simplification of the current procedure and introduce more flexibility in its application.

Background

3. The problem of arrears first became evident in 1981 and has continued to increase, reaching a level of USD 54 million as at 30 June 1999. This delinquency situation is mainly concentrated in Africa, with 54% of total arrears, and in one country in the Latin America and the Caribbean Region that accounts for 27%. The table on page 5 shows the status of arrears of over 300 days by country, grouped by lending terms. Details of the delinquency situation may be found in document EB 99/67/R.4. IFAD has maintained a continuous dialogue with countries in arrears to ensure that they honour their obligations to IFAD. Procedures have been put in place to initiate dialogue with countries in arrears as soon as problems emerge. Some results have been achieved: the number of loans with arrears of over 75 days has fallen from 40 loans at the end of 1997 to 33 at the end of June 1999. Furthermore, various settlement packages have been concluded with countries having significant, long-overdue arrears. However, the success of these packages in resolving arrears has varied from country to country.



Results and Problems Encountered

4. Prior to the introduction of the current arrears policy, arrears settlement packages totalling USD 13 297 000 had been negotiated and accepted by the following countries: Cameroon, The Congo, Guinea-Bissau and Niger. So far, only two of those countries have adhered to the settlement agreements, i.e., Cameroon and Niger, and IFAD has been able to reactivate project implementation and design in these countries. In The Congo and Guinea-Bissau, the outbreak of serious civil disturbances was the most important factor contributing to non-adherence. It is important to note that the four packages were negotiated on the nominal value of the overdue loan charges. No additional charge or penalty was added, since billing procedures applied by IFAD for the payment of loan charges take into account all loan-related transactions on a six-monthly basis up until the due date. As in the practices of other international financial institutions (IFIs), if any principal instalment was not paid at the due date, the principal component was charged with the interest rate or service charge of the loan in the subsequent billing statements.

5. Since the introduction of the NPV-based policy in February 1998, only one settlement case, for The Comoros, has been negotiated and approved by the Executive Board (July 1998). Two other cases, Gabon and Sierra Leone, are being submitted for approval at this session. The need to have each settlement package approved by the Executive Board has encumbered the arrears-settlement negotiation process and led to delays in implementation.

6. The limited number of countries willing to take advantage of settlement packages – particularly those under highly concessional terms or with long-standing arrears – seems to be essentially due to the rigidity caused by the strict application of the NPV concept. It has been observed during negotiations with delinquent borrowers that the additional charge resulting from the application of this concept creates difficulties and reluctance to enter into an agreement. The concept is used within the Heavily-Indebted Poor Countries (HIPC) Debt Initiative as a basis for treating debt forgiveness, but not for dealing with arrears. The World Bank, for example, does not apply it to arrears. The concept of NPV is used as a common denominator to measure the present value of the stream of nominal future repayments and serves the purpose of calculating the present value of debt relief to be contributed by each IFI in the HIPC Debt Initiative. The application of NPV in the context of arrears settlement packages is having a negative impact, as it increases the charges and sanctions applied on overdue payments. IFAD already applies sanctions in a gradual approach beginning with the suspension of disbursement of the delinquent loan (75 days after the due date), followed by country portfolio suspension (120 days after) and, finally, the placement of the country in non-accrual status (300 days after).

7. The following brief account highlights the practical difficulties encountered in negotiating arrears settlement packages within the new policy framework:

(a) Slow IFAD Response to Settlement Packages

As every settlement package must be approved by the Executive Board, delays in concluding and implementing settlement packages are encountered. This has a negative impact on the resumption of implementation of ongoing projects when the country portfolio is active. In May 1998, for example, an IFAD mission to The Comoros discussed the arrears situation that had led to the suspension of disbursements from outstanding loans. The mission reached agreement with the Government on an arrears payment plan involving a series of instalments. Given the urgency of the matter, it was necessary to obtain the authorization of the Executive Board by means of a vote by correspondence, notwithstanding the modest amount involved. The voting procedure was lengthy and caused delays in the implementation of the plan. Waiting for the Executive Board's regular session would have further delayed the approval process. Similar delays



are being encountered with the settlement plan for Sierra Leone; the requirement to wait for Executive Board approval has already delayed implementation of the plan by three to four months.

(b) Additional Burden on Countries with Highly Concessional Terms or Facing Special Circumstances Caused by Application of NPV-Based Methodology

Since the Governing Council decision to apply the NPV value of overdue payments, a number of borrowers with which IFAD is working closely to solve long-standing arrears have indicated that this charge significantly increases their financial burden. This penalizes countries with highly concessional terms, which already confront difficult financial situations, as well as other countries facing serious financial problems due to exceptional situations.

- (i) **Countries with highly concessional terms.** The case of Sierra Leone presented to the present session reflects this problem. The country portfolio was suspended as of 15 November 1997 due to non-payment of arrears. Non-payment was the result of civil war and a subsequently difficult financial situation that rendered the Government of Sierra Leone unable to settle arrears. Following an IFAD mission, the borrower requested that IFAD work out a settlement plan for their consideration. As at 31 July 1999, the total amount owed by the Government of Sierra Leone was approximately USD 1.4 million. IFAD has worked out a plan for the rescheduling of the overdue loan charges over a period of two years, taking into account the NPV methodology. However, the application of NPV aggravates the financial situation of the borrower by increasing its financial burden and, as a consequence, reduces the country's ability to service its loan charges in general. This is contradictory to the message given by the international community in recent years to address the financial problems of the poorest countries.
- (ii) **Special cases.** For countries with long-standing arrears problems, application of the NPV approach is equally problematic. For example, the overdue charges of Liberia combine loans on highly concessional and intermediate terms, for which arrears are spread over a period of 10 years from 1989 through 1999, with a total of overdue charges equivalent to about USD 12.6 million. If we envisage a plan of payment with application of NPV, this would add a total of USD 5.0 million to the USD 12.6 million overdue, i.e., 40% of the total arrears. Such a situation would be faced by any country having long-standing arrears, whether qualifying for highly concessional, intermediate or ordinary loans.

Conclusion

8. In an effort to encourage acceptance of arrears settlement packages within the policy framework adopted by the Governing Council, a certain amount of flexibility could be introduced by IFAD through the adoption of the following measures. The Executive Board is therefore invited to consider the following:

The Executive Board could recommend to the Governing Council that paragraph 32(g) of IFAD's Lending Policies and Criteria be amended so as to remove the requirement that the NPV be secured in reaching agreement with a country on an arrears settlement package, provided that the nominal value of the arrears is maintained, as follows:

- (a) for all countries receiving IFAD loans on highly concessional terms, the President may approve settlement packages for those countries in arrears. The President would be



requested to report the details to the Executive Board at the session immediately following the conclusion of an arrears settlement; and

- (b) for those countries receiving IFAD loans on intermediate and ordinary terms, the Executive Board may approve arrears settlement packages for those countries in arrears to IFAD for more than one year, where the arrears are attributable to civil strife, dire economic or political conditions or *force majeure* that in the opinion of the Executive Board constitute sufficient extenuating circumstances.

ARREARS OF OVER 300 DAYS (NON-ACCRUAL STATUS) BY LENDING TERMS

As at 30 June 1999 (USD)

Borrower	Lending Terms	No. of Days Overdue	Principal	Interest	Total
Gabon b/	Ordinary	376	1 028 619	420 064	1 448 683
Cuba	Intermediate	3 540	9 349 206	4 248 707	13 597 913
Liberia	Highly concessional*	3 646	8 293 748	4 297 869	12 591 617
Somalia	Highly concessional	3 090	5 835 938	2 075 837	7 911 775
D.R. Congo	Highly concessional	2 416	3 690 122	1 773 265	5 463 387
Cameroon a/	Highly concessional	2 266	3 006 274	1 039 121	4 045 395
Congo a/	Highly concessional*	2 250	1 837 032	706 605	2 543 637
Guinea-Bissau a/	Highly concessional	1 320	441 553	188 826	630 379
Niger a/	Highly concessional	1 246	263 550	279 404	542 954
Comoros b/	Highly concessional	540	72 740	31 254	103 994
Sierra Leone b/	Highly concessional	526	802 374	379 780	1 182 154
		Total	34 621 156	15 440 732	50 061 888

a/ Settlement plan agreed by IFAD prior to implementation of the 1998 policy framework on arrears (no NPV included).

b/ Settlement plans for Gabon and Sierra Leone that include the NPV concept will be presented to the this session of the Executive Board for approval. The plan for The Comoros was approved by a vote by correspondence in July 1998.

* Country has moved from intermediate to highly concessional terms.



