INTERNATIONAL MONETARY FUND

Review of Fund Facilities—Preliminary Considerations

Prepared by the Policy Development and Review Department
in consultation with other Departments

March 2, 2000

Contents | Page

I. Historical Background and Overview of the Present Facilities....4

II. Members and their Use of Fund Resources....19

III. A Possible Simplification of the Structure of Facilities....30
A. Outright Purchases....30
B. Non-Core Facilities with Upper Credit Tranche Conditionality....33

IV. Some Fundamental Issues....35
A. Crises of Capital Market Confidence....37
(i) The resolution of crises....37
(ii) The prevention of crises....41
B. Other Fund Financing....45
(i) Principles....46
Fund financing for members with ongoing access to capital markets....46
Fund financing for members with *ex ante* extended balance of payments difficulties....48
Prolonged use of Fund resources....50
(ii) Policies....52
The rate of charge....52
Repurchases....54
Conditionality....56

Boxes

Box 1. The Credit Tranche Policies - Stand-By Arrangements....6
Box 2. The Compensatory Financing Facility (CFF)....8
Box 3. Defunct (or Near-Defunct) Instruments....9
Box 4. The Extended Fund Facility (EFF)....10
Box 5. Emergency Assistance for Natural Disasters....12
Box 6. Emergency Assistance for Post-Conflict Countries....13
Box 7. Fund Support for Debt and Debt Service Reduction (DDSR) Operations....14
Box 8. Currency Stabilization Funds (CSFs)....15
Box 9. Supplemental Reserve Facility (SRF)....16
Box 10. Contingent Credit Lines (CCL)....17

Tables

Table 1. The Fund's facilities....20
Table 2. Countries making purchases in the GRA between 1989 and 1999....21
Table 3. Use of facilities between 1989 and 1999....23

Figures

Figure 1. Evolution of Fund credit and loans outstanding, 1970–99....25
Figure 2. General resources purchases and repurchases, financial years ending April 30, 1970–99....25
Figure 3. Access levels for arrangements in the GRA, 1989–99....26
Figure 4. Percentage of members with outstanding GRA resources within given ranges..27

Annexes

Annex I. Issues for Discussion....58
Annex II. The GRA Rate of Charge, and Other Charges on the Use of Fund Resources.60
Annex III. Early Repurchases Under Article V, Section 7 (b)....61
Annex IV. Prolonged Use of Fund Resources....64
Annex V. Possible Mechanics of an Amended CFF....66

1. **At the turn of the millennium, and as part of the debate on reform of the international financial architecture, it is appropriate for the Fund to reflect on the role and design of its financial facilities.** Two issues stand out in this respect: first, whether all the existing facilities are still needed, or whether some could be eliminated; second, whether the facilities the Fund chooses to retain are appropriately designed. These issues might be characterized respectively as "housecleaning" and "renovation."

2. **The main purpose of this paper is to lay out a comprehensive view of the Fund's existing facilities as they relate to its role in today's global economic environment, and to lay the basis for a further work program.**[1] To an important extent, the questions posed in the area of renovation are really questions about the Fund's role; the paper approaches them through the intermediary of the facilities in order to ground the discussion in the decisions that will eventually need to be made. Considerable additional reflection will no doubt be needed before final decisions in the area of renovation can be made. The issues in the area of housecleaning are a good deal simpler, and some follow on from an earlier discussion the Board had, in January 2000, of the Compensatory Financing Facility.[2] Should the Board wish to move rapidly to take action in this area, it may be possible to circulate draft decisions for approval on a lapse of time basis following the Board discussion.

3. **The paper often refers generically to the Fund's various policies on the use of its resources as "facilities," although this terminology is not, strictly speaking, correct.** The term "facilities" normally refers to those policies on the use of Fund resources that are outside the credit tranches (currently, the Compensatory Financing Facility, the Extended Fund Facility, the Supplemental Reserve Facility, and the Contingent Credit Lines). The other policies on the use of the Fund's resources relate to the credit tranches (e.g., stand-by arrangements, emergency assistance, etc.), and are *not* technically facilities (see paragraphs 8 and 25). Nevertheless, for the sake of presentational simplicity, the paper refers collectively to the various policies on use of Fund resources as "facilities."

4. **The paper considers only the Fund's facilities in the General Resources Account (GRA).** The Poverty Reduction and Growth Facility (PRGF) is a facility administered by the

---

[1] That work program could include four papers on various aspects of the Fund's facilities that were planned before it was agreed that the present paper would take precedence: a paper on the compatibility of precautionary arrangements with the eligibility criteria for the Extended Fund Facility; a review of Contingent Credit Lines; a paper on post-program monitoring; and a review of the early repurchase policy.

[2] See "Summing Up by the Acting Chairman, Review of the Compensatory and Contingency Financing Facility (CCFF) and Buffer Stock Financing Facility (BSFF)—Preliminary Considerations, EBM/00/5, January 14, 2000," BUFF/00/9. On that occasion, the Board agreed to eliminate the contingency element of the CCFF, as well as the BSFF. Decisions to this effect, and changing the name of the CCFF to the Compensatory Financing Facility, came into effect on February 15, 2000.

Fund as a trustee, and has just undergone a major redesign. It will not be considered, except insofar as its existence may influence the design of the other facilities.

5. **The paper is organized as follows.** Chapter I gives a brief historical overview of the development of the present facilities, and also includes, in boxes and for easy reference, descriptions of the current features of each of the existing facilities. Chapter II presents a thumbnail description of the diversity of members and of their use of Fund resources in the 1990s. Chapter III addresses the housecleaning issues. In doing so, it leaves aside what might be considered the core facilities—policies on stand-by arrangements, extended arrangements, the SRF, and the CCL—and focuses on whether there is (still) a role for the other facilities. Chapter IV turns to the four core facilities, and asks—in a preliminary fashion—a number of fundamental questions relating to whether they are consistent with the current and prospective needs of the institution and its members, and how their design might be improved to ensure such consistency. At the end of each subsection of Chapters III and IV, issues for discussion by the Board are summarized in an italicized paragraph, and these are grouped together for easy reference in Annex I. A number of other annexes are also attached.

I. Historical Background and Overview of the Present Facilities [3]

6. **The Fund's facilities have evolved over time, as the Fund has sought to pursue its fundamental objectives while adapting to changing circumstances.** The Fund was created, at the end of the Second World War, out of the realization that competitive devaluation and restrictive policies had brought disorderly and costly adjustment in the inter-war period. It was charged both with preventing such disorder in the future and with encouraging members to adopt the more open policies necessary to sustain world economic growth—in part, by providing financing. The Articles of Agreement provide that a key purpose of the IMF is "to give confidence to members by making the Fund's resources temporarily available to them under adequate safeguards, thus providing them with opportunity to correct maladjustments in their balance of payments without resorting to measures destructive of national or international prosperity" (Article I (v)).[4]

7. **The Fund's resources were intended to revolve among its members, and the initial provisions for repurchases and for charges on purchases were designed**

---

[3]This chapter draws heavily on: Horsefield, J.K., "The International Monetary Fund, 1945-1965—Twenty Years of International Monetary Cooperation," IMF, Washington DC, 1969; Garritsen de Vries, M., "The International Monetary Fund, 1966-1971—The System Under Stress," IMF, Washington DC, 1976; Garritsen de Vries, M., "The International Monetary Fund, 1972-1978—Cooperation on Trial," IMF, Washington DC, 1985; and Boughton, J.M., "The International Monetary Fund, 1979-1989—Silent Revolution," IMF, Washington DC, forthcoming.

[4]The word "temporarily" was added to Article I (v) in 1969, by way of clarification.

accordingly.[5] Members were to repurchase their currencies as they were able to do so, thus making the Fund's resources available for other members to use as needed. Members were to make repurchases as their holdings of external reserves improved. Charges on outstanding purchases were low and did not vary with market interest rates, but, in order to provide incentives for repurchase, they increased both with the amount of purchases outstanding relative to quota and with the time for which the purchases had been outstanding.

8. **The Articles (specifically, Article V, Section 3(a)) charge the Fund with developing policies on the use of its general resources, as well as allowing it to adopt special policies for special balance of payments problems.** For over a decade and a half after its creation, the Fund developed policies only on use of Fund resources in what came to be known as "the credit tranches." No policies directed at meeting the needs of members with special balance of payments problems, stemming from particular sources, were adopted until 1963.

9. **It was not long before the Fund developed stand-by arrangements as the main instrument through which members would access the credit tranches** (Box 1).[6] Whether rights to draw should be automatic or conditional had been a topic of keen debate at the time the Articles were framed. For a short time, the Fund experimented with automatic rights to purchase, but the existing repurchase obligations were at the same time proving ineffective. This combination cast doubt on the revolving character of Fund resources. In 1952, the Board took a historic decision establishing stand-by arrangements (the Rooth Plan), as a means by which members could be assured of being able to purchase foreign exchange during a specified period (typically, initially, 6-12 months), if they needed to do so, while the Fund could be assured of the member's ability to repay. Stand-by arrangements were originally conceived as precautionary instruments—that is, it was thought that the right to purchase would be, in itself, sufficient to satisfy the member's requirements, without a purchase actually being made. Precautionary arrangements have remained an important instrument through the decades, even though the typical stand-by arrangement came to be one that helped members meet their immediate balance of payments needs. Stand-by arrangements were incorporated in the Articles of Agreement in 1978, when they were defined as "a decision by the Fund by which a member is assured that it will be able to make purchases from the General Resources Account in accordance with the terms of the decision during a specified period and up to a specified amount" (Article XXX (b)).

---

[5]When the Fund provides financing to a member, it provides the currency of other members in exchange for that member's currency (these are "purchases" by the member from the Fund). The transactions are reversed by means of "repurchases."

[6]In general, members can access the credit tranches (or indeed any Fund resources) either by means of arrangements or by means of "outright purchases." Outright purchases differ from arrangements in that there is no phasing conditional on future policy performance.

Box 1. The Credit Tranche Policies - Stand-by Arrangements

Stand-by arrangements are available for **any balance of payments need**.

The **length** of stand-by arrangements is typically 12-18 months, although they range from a minimum of about six months (there is no legal minimum) to a legal maximum of three years.

For a member that has no Fund credit outstanding, the first 25 percent of quota access under a stand-by arrangement is subject to "**first credit tranche conditionality.**" The Fund's attitude to requests in the first credit tranche is a liberal one, while requests beyond this require substantial justification.

All stand-by arrangements beyond the first credit tranche feature **phasing of purchases** conditional on performance clauses (applying only to purchases beyond the first credit tranche).[1]

Access under stand-by arrangements (together with access under the Extended Fund Facility) is subject to **limits** of 100 percent of quota annually and 300 percent of quota cumulatively. The Fund may grant access beyond the limits in exceptional circumstances.

Purchases under the credit tranche policies are subject to the GRA **rate of charge** (Annex II), and to **repurchase obligations** of 3 ¼ - 5 years from the date of purchase (eight quarterly installments).

[1/]Guidelines on Conditionality, Decision No. 6056-(79/38), adopted March 2, 1979, *Selected Decisions and Selected Documents of the International Monetary Fund, Twenty-Fourth Issue* (June 30, 1999), pages 137-139.

10. **During the late 1950s the Executive Board developed the Fund's policy on the first and upper credit tranches.** In 1959, it stated that "The Fund's attitude to requests for transactions within the first credit tranche ... is a liberal one, provided that the member itself is also making reasonable efforts to solve its problems. Requests for transactions beyond these limits require substantial justification. They are likely to be favorably received when the drawings or stand-bys are intended to support a sound program aimed at establishing or maintaining the enduring stability of the member's currency at a realistic rate of exchange."[7]

11. **The tension between the two objectives of the credit tranche policies—assurances for the member and safeguards for the Fund—took some time to resolve.** Nonetheless, by the late 1950s the present structure of upper credit tranche policies, featuring phasing of purchases and performance criteria, had become well established. This structure would eventually be codified in the guidelines on conditionality that the Board adopted in 1968 (and revised in 1979). The policy the Fund had followed since the 1950s was that

[7]While the introduction of stand-by arrangements did not do away with the possibility of outright purchases in the upper credit tranches (i.e., purchases in the upper credit tranches made outside the context of arrangements), these became increasingly rare, and (except for a limited number of purchases in the upper credit tranches under the policy on emergency assistance, see below) there have been none since 1968.

repurchases in the credit tranches were to be made no later than three to five years after the date of each purchase. In practice, members usually repurchased toward the end of this period, until the passage in 1978 of the Second Amendment to the Articles, which stipulated that repurchases should be made not later than five years after the date of a purchase, and allowed the Fund to prescribe—as it has—that repurchases should be made beginning three years and ending five years after the date of purchase (Article V, Section 7 (c)).

12. **The limits on access in the credit tranches were initially those set in the Articles, but, in time, the credit tranches would become subject to a separate set of limits, established from time to time by the Board.** The original Articles specified that purchases would not exceed an annual limit of 25 percent of quota, or (essentially) a cumulative limit of 100 percent of quota, which the Fund was empowered to waive (and frequently did). With the introduction of separate facilities (see below) would come additional, separate access limits, and by the early 1980s (and in part reflecting the Second Amendment of the Articles in 1978), the credit tranches, together with the Extended Fund Facility (EFF), had become subject to separate annual and cumulative access limits, which could be exceeded only in "exceptional circumstances."[8] Over time, the limits have risen, relative to the levels initially set in the Articles, reflecting in part the fact that quotas did not keep up with the growth in demand for Fund resources. The limits ranged up to highs of 200 percent (annual) and 600 percent (cumulative) of quota (for a short period in 1980).[9] For most of the 1990s, the limits have been at their current levels—100 percent and 300 percent of quota, respectively.

13. **In 1963, the Fund established the Compensatory Financing Facility (CFF)** (Box 2) as a response to fluctuations in the prices of primary commodities that afflicted many countries in almost every region of the globe.[10] As originally designed, the CFF provided additional access to countries that had suffered temporary export shortfalls, with lower conditionality and with immediate rather than phased disbursements. The Fund, however, explicitly rejected proposals to make access to the facility automatic for countries with export shortfalls.

---

[8]The annual limit of 25 percent of quota was eliminated by the Second Amendment. The cumulative limit of 100 percent of quota—which is expressed in the Articles as a ceiling of 200 percent of quota on the Fund's holdings of a member's currency—was retained, subject to the possibility of waiver, which is now regularly granted where necessary to allow access in line with the operational limits the Fund establishes from time to time.

[9]At various times—either when quota increases were delayed or when it was decided that access limits had to be relatively high—the Fund engaged in borrowing to supplement quota resources (notably, between 1977 and 1992, it borrowed under the Supplementary Financing Facility and the Enlarged Access Policy).

[10]"Compensatory and Contingency Financing Facility," Decision No. 8955-(88/126), adopted August 23, 1988, *Selected Decisions and Selected Documents of the International Monetary Fund, Twenty-Fourth Issue* (June 30, 1999) (hereafter referred to as *Selected Decisions),* pages 222-251.

Box 2. The Compensatory Financing Facility (CFF) [1]

The main **purpose** of compensatory financing is to ensure timely financing for members that are experiencing balance of payments difficulties resulting from a temporary decline (rise) in export earnings (cereal import costs). The eligibility requirements are: (1) the export shortfall and/or excess cereal import cost must be considered temporary, i.e., a deviation from trend that is expected to be reversed; (2) the shortfall/excess must be attributable to factors largely beyond the control of the authorities; (3) the member has to have a balance of payments need; (4) where the member has balance of payments difficulties beyond the effects of the shortfall/excess, the member is expected to cooperate with the Fund in an effort to address its balance of payments difficulties.

Under the export element, compensation can be provided for a shortfall in total merchandise export earnings (and not for any subset of any export components). Receipts from services (excluding investment income) may be considered if reliable statistics are available. Coverage of the cereal element is limited to imports of cereal (excluding any concessionally financed cereal imports). An excess in cereal import costs may be compensated only to the extent that it is not offset by an excess of export earnings.

Access under the CFF does not count toward the access limits under the credit tranches and the EFF, and is subject to its own **limits**. Access limits depend on: (1) the member's balance of payments position; (2) its past cooperation with the Fund to resolve its balance of payments difficulties; and (3) its willingness to adopt adjustment policies that would meet the standards of upper credit tranche conditionality. Depending on these considerations, access limits range from 10 percent to 55 percent of quota. Within these limits, access is determined by the size of the shortfall/excess, and may be limited by Fund judgments on the member's capacity to repay. Access is not phased but may be "tranched" if nine or more months of data are estimated, according to predetermined calculation methods.

The CFF does not "**float**" as regards conditionality—i.e., a member with 25 percent of quota or more credit outstanding under the CFF cannot access the credit tranches with first credit tranche conditionality.

Purchases under the CFF are subject to the GRA **rate of charge** (Annex II), and to **repurchase obligations** of 3¼–5 years from the date of purchase.

[1/] A more detailed description of the CFF can be found in "Review of the Compensatory and Contingency Financing Facility—Preliminary Considerations," EBS/99/222, December 9, 1999.

14. **The CFF was to undergo several cycles of liberalization and tightening**, and its significance in Fund financing varied over time, with developments in world commodity markets and as the Board tried to find the right balance between financing and conditionality. A cereal import element was added in 1981, following the increased volatility of food prices in the 1970s. Initially introduced for a period of four years, the cereal element has since been routinely extended. In 1988, the CFF became the Compensatory and Contingency Financing Facility (CCFF), as it acquired an additional element, the contingency element, which could be included in a Fund arrangement in order to provide protection against exogenous current account shocks. The contingency element never generated much interest from members. It was eliminated in early 2000, along with the Buffer Stock Financing Facility, which had been established in 1969 but had fallen into disuse.[11] At that time, the Board also expressed strong

[11] Box 3 contains a summary of instruments that no longer exist.

sentiment in favor of confining stand-alone CFF purchases to cases in which the balance of payments position is satisfactory apart from the export shortfall or cereal import excess.

Box 3. Defunct (or Near-Defunct) Instruments

Over the years, the Fund created a number of policies to meet particular types of balance of payments needs, which eventually were either eliminated or allowed to lapse:

- The **Buffer Stock Financing Facility**, created in 1969 and eliminated in 2000, provided financing to members to help finance their contributions to approved commodity price stabilization funds.
- The **first Oil Facility** was created in June 1974 in response to the oil price shock, and lapsed in December 1974. A **second Oil Facility** was created in April 1975 to provide additional financing, and lapsed in March 1976.
- An **oil import element** was added to the Compensatory and Contingency Financing Facility in November 1990, when oil prices rose sharply during the Gulf War. It was allowed to lapse at end-1991.
- The **Systemic Transformation Facility**, created in April 1993 and allowed to lapse in April 1995, provided support for the early stages of transition from centrally planned to market economies, in relatively small amounts and with relatively low conditionality.
- The **contingency element** of the **Compensatory and Contingency Financing Facility**, created in 1988 and eliminated in 2000, provided additional access under arrangements, according to prespecified calculations, in the event of unanticipated adverse current account developments.
- The **Y2K Facility** was created in September 1999, to deal with possible strains resulting from the Y2K computer bug. It has not been used, and is scheduled to lapse at end-March 2000.

15. **The Fund established the Extended Fund Facility (EFF) in 1974,** as a vehicle for longer-term financing to countries in need of structural economic reforms (Box 4).[12] [13] The creation of the EFF reflected an increasing recognition that balance of payments problems could have structural origins, and thus could require both an extended period of adjustment and policy changes that would strengthen the productive and export base of the economy. The

---

[12]Decision No. 4377-(74/114), adopted September 13, 1974, *Selected Decisions*, pages 150-154.

[13]Also, in 1974-75, the Fund created two successive Oil Facilities (see Box 3). These lapsed after two years, and from the standpoint of the present paper were notable mainly because they were the first instance of a quick, temporary response by the Fund to a global crisis, and because the rate of charge on these facilities approached commercial rates (as the resources were entirely from borrowed funds, and the Fund passed on its costs in this respect—as it would again under the Supplementary Financing Facility and the Enlarged Access Policy, see footnote 9).

EFF offered longer repayment periods and (initially) larger access than did the credit tranche policies, but, in return, it required more action in the structural area than was typical of stand-by arrangements.

Box 4. The Extended Fund Facility (EFF)

The EFF was established in 1974 with the **purpose** of providing medium-term assistance in particular to members with "(a) an economy suffering serious payments imbalance relating to structural maladjustments in production and trade and where price and cost distortions have been widespread; (b) an economy characterized by slow growth and an inherently weak balance of payments position which prevents pursuit of an active development policy."

The **length** of extended arrangements is typically three years, with a possibility of extension for a fourth year.

Extended arrangements are subject to **phasing** provisions similar to those under stand-by arrangements. The **policy conditions** necessary for Fund support through the EFF include implementation of structural reforms over an extended period.

Access to the EFF (together with access under the credit tranches) is subject to **limits** of 100 percent of quota annually and 300 percent of quota cumulatively. The Fund may grant access beyond the limits in exceptional circumstances.

Purchases under the EFF are subject to the **GRA rate of charge** (Annex II), and to **repurchase obligations of 4 ½ - 10 years** from the date of purchase (twelve semiannual installments).

16. **Over the years, financing under the EFF went through some wide cycles.** A first rise and fall ended with the facility little used in 1983-88. This may have partly reflected an evolution in the credit tranche policies, whereby these came to incorporate more structural elements and, in some cases, longer adjustment periods. In addition, the EFF had been brought under the same access limits as the credit tranches in 1979. As a result, the distinctions between upper credit tranche stand-by and extended arrangements were becoming more difficult to discern. Moreover, from 1986 onward, low-income countries—among the countries most expected to make use of the EFF—had a more attractive alternative in the Fund's concessional lending instruments, the Structural Adjustment Facility (SAF) and the Enhanced Structural Adjustment Facility (ESAF).[14] Nonetheless, from 1988 onward the EFF again came into greater use, first in association with operations under the international debt strategy,[15] but also, in the ensuing years, reflecting an increased willingness by many

[14]The Fund established the SAF in 1986 for "all low-income countries eligible for IDA resources that are in need of such resources and face protracted balance of payments problems", and its successor, the ESAF, in 1987. In 1999, the ESAF was replaced by the Poverty Reduction and Growth Facility (PRGF). As noted above, the PRGF is a trust administered by the Fund, as was its predecessor, the ESAF.

[15]Fund support for debt and debt service reduction (see paragraph 20) was linked to "medium-term adjustment programs with a strong element of structural reform".

developing countries to commit themselves to fundamental reform under longer-term policy programs.

17. **In 1978, the Fund's policies on repurchases were reformulated** as part of the Second Amendment of the Articles of Agreement. While it established time-bound repurchase obligations (see paragraph 11 above), the Second Amendment also retained (under Article V, Section 7(b)) the notion that members would be expected to make early repurchases as their balance of payments and reserve positions improve. A set of guidelines, which took their present form in 1979, clarifies how judgments about external strength are to be made and how the resulting early repurchase expectations are to be calculated and met (Annex III). In the subsequent two decades, 11 members have been called on to make early repurchases under the guidelines, which resulted in 38 early repurchases. No member has been subject to an early repurchase expectation under the guidelines since 1994—a period that coincides, however, with sizable voluntary advance repurchases by several members. No member has ever failed to meet an early repurchase expectation under Article V, Section 7 (b).

18. **In the years after the Second Amendment, the system of rates of charge was made simpler and more flexible, and a link to market interest rates was introduced.** The Second Amendment tied the remuneration rate paid to creditors to market interest rates, which were at the same time rising sharply, and it became evident that the low, set rates of charge could not be sustained.[16] In 1981, the graduated schedule of charges on credit tranche purchases was replaced with a unified rate of charge, and that rate was linked to market rates, being set annually (subject to review) based on a net income target for the Fund (see Annex II, which also describes the service charge and the commitment fee).[17] When a problem of arrears to the Fund emerged in the mid-1980s, a system of "burden-sharing" was introduced, whereby certain financial costs associated with arrears, including the cost of building precautionary balances, are allocated to both creditor and debtor members, through adjustments to the rates of charge and remuneration.[18] Starting in 1989, the rate of charge was linked directly to the SDR interest rate, and adjusted weekly.

19. **In 1982, the Fund developed the policy on emergency assistance for natural disasters, and a little over a decade later adopted similar procedures for post-conflict cases.** Emergency assistance for natural disasters (Box 5), which had first been introduced in

---

[16]The remuneration rate is the rate paid to members who provide their currencies for use by other members.

[17]The unified system would last until 1997, when a surcharge was introduced on use of resources under the Supplemental Reserve Facility (and later also under the Contingent Credit Lines) (see paragraphs 23–24).

[18]In 1984, only one member was overdue in its obligations to the Fund by a year or more. This number increased steadily over the next 5 years, and by 1989 there were 11 such members. Since 1993 the number has slowly decreased, and as of end-1999 stood at 7 (including one country that is currently not a member of the Fund).

1962, picked up, both in frequency and average size, beginning in 1979.[19] In February 1982, the Executive Board agreed that a special facility was not needed, and accepted the idea that emergency assistance (in the credit tranches) should be subject to a similar degree of conditionality as the first credit tranche.[20] Emergency assistance was extended to post-conflict situations in 1995, in order to provide assistance to countries where the conflict had disrupted institutional and administrative capacity (Box 6).[21]

Box 5. Emergency Assistance for Natural Disasters

The **purpose** of emergency assistance for natural disasters is to provide quick financial assistance to member countries which are afflicted by natural disasters. Emergency assistance is not a facility, but a flexible application of the existing policies on use of the credit tranches. Emergency assistance is used in cases where a member cannot meet its immediate financing needs—arising from a major natural disaster such as a flood, earthquake, or hurricane—without serious depletion of its external reserves In most cases, however, assistance is expected to be provided in these circumstances under the CFF or a stand-by or extended arrangement.

The **policy conditions** required for emergency assistance include a statement of the general policies the affected country plans to pursue. A request is granted when the Fund is satisfied that the member will cooperate with the Fund in an effort to find, where appropriate, solutions for its balance of payments difficulties.

Emergency assistance takes the form of an outright purchase with **access** limited to 25 percent of quota, although larger amounts can be made available exceptionally.

Purchases under emergency assistance for natural disasters are purchases in the credit tranches and are therefore, like stand-by arrangements, subject to the GRA **rate of charge** (Annex II), and to **repurchase obligations** of 3 ¼ - 5 years from the date of purchase.

[19] In 1962, the Fund had agreed to lend a member 25 percent of quota, noting that the request was motivated by a dire economic emergency. In the following 17 years, the Fund provided emergency assistance for natural disasters in only four instances.

[20] "Emergency assistance – Natural Disasters, the Chairman's Concluding Remarks", EBM/82/16, *Selected Decisions*, pages 172-175.

[21] "Summing Up by the Chairman – Fund Involvement in Post-Conflict Countries," EBM/95/82, September 6, 1995, *Selected Decisions,* pages 175-178.

Box 6. Emergency Assistance for Post-Conflict Countries

The **purpose** of extending emergency assistance to include post-conflict situations is to provide balance of payments assistance to countries where the institutional and administrative capacity has been disrupted as a result of the conflict, so that the member is not yet able to develop and implement a comprehensive economic program that could be supported by a Fund arrangement, but where there is nonetheless sufficient capacity for planning and policy implementation and a demonstrated commitment on the part of the authorities; where there is an urgent balance of payments need and a role for the Fund in catalyzing support from other sources; and where Fund support is part of a concerted international effort to address the aftermath of the conflict situation in a comprehensive way.

Policy conditions include a statement of economic policies; a quantified macroeconomic framework to the extent possible; and a statement by the authorities of their intention to move as soon as possible to an upper credit tranche stand-by or extended arrangement, or to a PRGF arrangement.

Access is generally limited to 25 percent of quota. However, larger amounts can be made available exceptionally—in particular, a further 25 percent of quota can be made available in cases where, in spite of the authorities' efforts, progress on capacity rebuilding is slow and where the member is not in a position to move to a Fund arrangement after about a year under a program supported by emergency assistance, and where there is sufficient evidence of the authorities' commitment to reform and capacity to implement policies. Tranching of total resources in some instances may help ensure the effective use of Fund resources and provide an incentive to develop a comprehensive economic program. (Tranching is different from phasing in that it is not conditional on prespecified policy performance; requests for the later purchase(s) under tranching are considered on their own merits.)

Purchases under emergency assistance for post-conflict countries are purchases in the credit tranches and are therefore, like stand-by arrangements, subject to the GRA **rate of charge** (Annex II), and to **repurchase obligations** of 3 ¼ - 5 years from the date of purchase.

20. **The Fund's policies on support for Debt and Debt Service Reduction (DDSR) operations date from 1989** (Box 7).[22] The aim is to provide financing, in conjunction with the World Bank and other official sources, for the upfront costs of members' DDSR operations with commercial banks. Fund support for such operations is provided under a stand-by or extended arrangement, or (since 1997) an ESAF/PRGF arrangement, which may be augmented for this purpose.

[22] "The Chairman's Summing Up on Fund Involvement in the Debt Strategy," EBM/89/61, May 23, 1989, *Selected Decisions*, pages 193-198.

Box 7. Fund Support for Debt and Debt Service Reduction (DDSR) Operations

The **purpose** of Fund support for commercial bank DDSR operations is to help finance the upfront cost of DDSR operations, as a means of helping members reach agreement with their commercial bank creditors. Set-asides (25 percent of access under Fund arrangements) and additional resources from augmentations (up to 30 percent of quota) are allowed to be used for instruments involving either debt or debt service reduction. The set asides and additional resources can be released once the member has reached an agreement with its commercial bank creditors, and so long as the Board agrees that Fund resources would be used effectively in support of debt and debt service reduction.

Support for DDSR operations can be provided through stand-by, extended, or PRGF arrangements. **Charges** and **maturities** are the same as those in the underlying arrangement.

21. **The Fund's policy on Currency Stabilization Funds (CSFs) was established in 1995** as an element within stand-by or extended arrangements (Box 8).[23] The purpose of the CSF element is to provide additional, precautionary balance of payments support in the initial stage of an exchange rate-based stabilization. No member has made use of this policy.

22. **The dominant development of the second half of the 1990s was the advent of large-scale Fund financing for crises of capital market confidence**, and the creation of the Supplemental Reserve Facility (SRF) and the Contingent Credit Lines (CCL).[24]

---

[23]"The Acting Chairman's Summing Up at the Conclusion of the Discussion on Fund Support for Currency Stabilization Funds," EBM/95/86, September 13, 1995, *Selected Decisions*, pages 183-192.

[24]Decision No. 11627-(97/123) SRF, adopted December 17, 1997, as amended (hereafter "the SRF/CCL decision"), *Selected Decisions,* pages 276-281, and "The Chairman's Summing Up on Contingent Credit Lines," EBM/99/48, April 23, 1999, *Selected Decisions,* pages 281-287.

Box 8. Currency Stabilization Funds (CSFs)

The **purpose** of the policy on Currency Stabilization Funds (CSFs) is to provide additional, precautionary balance of payments support in the initial stage of an exchange rate-based stabilization. A program fully consistent with the targeted exchange rate anchor would be necessary to obtain Fund support for a CSF, so that little, if any, use of CSF resources would be expected.

The **policy conditions** necessary for Fund support for a CSF comprise: (i) fiscal and credit targets consistent with the inflation objective; (ii) appropriate measures to deal with indexation schemes, if present; (iii) a highly liberalized current account; (iv) contingency plans for large flows of capital, including fiscal contingency plans and full interest rate flexibility; (v) integrated management of foreign exchange reserves and intervention policy; and (vi) other structural and institutional elements conducive to a sharp inflation reduction and more specific conditions depending on the particular circumstances. Daily reporting of key financial variables such as exchange rates, interest rates, exchange market turnover, intervention, and reserves is expected while a CSF element is in place.

To permit the **release of resources** under the CSF element of an arrangement, the Board must determine that (i) the exchange rate policy is realistic, sustainable, and firmly supported by fiscal and monetary policies, (ii) the program is fully financed, and (iii) adequate monitoring and reporting procedures are in place and functioning.

Use of CSF resources would normally be phased in four **tranches,** with a minimum of three and a maximum of five tranches. The first tranche becomes available upon activation of the CSF element by the Executive Board; cannot exceed 35 percent of access under the CSF element; and may, after it is repurchased, be redrawn freely for the duration of the CSF. Subsequent tranches can be drawn upon further review by the Board, within two weeks of Board approval, and their repurchase reconstitutes the member's right to request CSF resources, but not the right to redraw without further review by the Board.

Access under stand-by and extended arrangements with a CSF element is subject to the same (annual and cumulative) limits as without this element. Access under the CSF element of the arrangement is capped at 100 percent of quota, within the normal access limits, and is measured on a "net basis" as outstanding use of CSF resources in percent of quota (that is, tranches that have been repurchased do not count toward access under the CSF).

Resources drawn under a CSF are subject to the GRA **rate of charge**. They are normally subject to the same **repurchase** *obligations* as other resources in the credit tranches (3¼-5 years), but with a one-year repurchase *expectation* for the first CSF tranche and a three-month expectation for the upper tranches (which can be extended up to a maximum of one year at the discretion of the Board). However, if the member's outstanding use of Fund credit exceeds 100 percent of quota (that is, if Article V, Section 4 applies), CSF purchases are normally subject to a one-year repurchase *obligation*. If the remaining time to expiration of the arrangement is longer than one year, the first CSF tranche is subject to a repurchase *obligation/expectation* upon expiry of the arrangement (up to 18 months from the time of purchase).

23. **The Fund established the SRF in late 1997** (Box 9). The very large arrangements for Mexico (1995), Thailand (1997), and Indonesia (1997)—in the range 490-690 percent of quota, compared with the cumulative access limit of 300 percent of quota—had been granted under the credit tranches, using the "exceptional circumstances" clause that permits access beyond the established limits. Following the arrangement for Mexico, the Fund had begun to discuss the possibility that additional safeguards for its resources might be required in the case

of such large arrangements, and that the repayment period and rate of charge under the credit tranches might not be appropriate for what came to be called "21st century" crises.[25] In December 1997, when Korea approached the Fund for a three-year stand-by arrangement for over 1900 percent of quota, the Fund granted the arrangement in the credit tranches, but two weeks later established the SRF, which featured shorter repayment periods and a higher rate of charge. The remainder of the arrangement for Korea was converted into an arrangement with SRF resources (as had been discussed with Korea beforehand), and the SRF has since been used two more times, by Russia and Brazil, both in 1998.

Box 9. Supplemental Reserve Facility (SRF)

The **purpose** of the SRF is to provide assistance to members that are experiencing exceptional balance of payments difficulties due to a large short-term financing need resulting from a sudden and disruptive loss of confidence reflected in pressure on the capital account and the member's reserves.

Access under the SRF is separate from the access limits under the credit tranches and the EFF, and the SRF is not subject to access limits of its own. SRF resources are, however, provided under stand-by or extended arrangements, in combination with credit tranche or EFF resources up to the annual or cumulative limit, whichever is binding.

Conditionality in an arrangement involving SRF resources is similar to that in a stand-by or extended arrangement.

SRF resources are subject to **repurchase** *expectations* at 1–1½ years from the date of purchase, and repurchase *obligations* at 2–2½ years from that date. The member may request an extension of the repurchase expectations by up to one year, but the Board may decide not to approve this request, and to turn unmet expectations into immediate obligations.

SRF resources are subject to a **surcharge above the GRA rate of charge**. During the first year from the date of the first purchase under the facility, the surcharge is set at 300 basis points, and it rises by 50 basis points at the end of the first year, and every six months thereafter, up to a maximum of 500 basis points.

24. **Shortly after the establishment of the SRF, the Fund turned its attention to the creation of a facility that would help prevent the spread of capital account-driven crises.** The result was the establishment of the CCL in May 1999 (Box 10). The CCL is available, in the absence of a crisis and as a precautionary mechanism, only to members that satisfy stringent eligibility criteria. No member has yet made use of the CCL.

---

[25] In addition, in 1995 the Fund established the Emergency Financing Mechanism (also known as "emergency procedures"), under which an arrangement may be brought to the Board in a shorter time frame than under the usual procedures ("Summing Up by the Chairman, Emergency Financing Mechanism," EBM/95/85, September 12, 1995, *Selected Decisions,* pages 179-183).

Box 10. Contingent Credit Lines (CCL)

The **purpose** of the CCL is to provide members with strong economic policies a precautionary line of defense which would be readily available against balance of payments problems that might arise from international financial contagion.

The CCL is subject to demanding **eligibility criteria**: (i) an absence of need for use of Fund resources from the outset, (ii) a positive assessment of policies by the Fund, taking into account the extent of the member's adherence to internationally-accepted standards (in particular, the member must have subscribed to the Special Data Dissemination Standard and be making satisfactory progress towards meeting its requirements); (iii) constructive relations with private creditors, with a view to facilitating appropriate involvement of the private sector, and satisfactory management of external vulnerability, and (iv) a satisfactory economic and financial program, which the member stands ready to adjust as needed.

As with the SRF, **access** under the CCL is separate from the access limits under the credit tranches and the EFF. CCL resources are provided under stand-by arrangements, in combination with credit tranche resources up to the annual or cumulative limit, whichever is binding. Commitments under the CCL are expected to be in the range of 300-500 percent of quota.

Upon approval of an arrangement involving CCL resources, a small purchase is made available (but not expected to be drawn). Thereafter, phasing is left unspecified. If a crisis strikes, the member may request completion by the Board of an "**activation review**," under which resources would be released and phasing and conditionality (similar to conditionality under the SRF) would be specified for the remainder of the resources. To complete the activation review, the Board must be satisfied that the member, having successfully implemented its program to date, is nevertheless severely affected by a crisis stemming from contagion, and that it intends to adjust policies as needed. If an activation review is not completed by a pre-specified date, a midterm review of the arrangement must be completed before a purchase associated with an activation review can be released.

CCL resources are subject to the same **repurchase** expectations and obligations (at 1–1½ years, and 2–2½ years, respectively, from the date of purchase), and the same **rate of charge** (incorporating a surcharge over the GRA rate of charge that rises from 300 to 500 basis points), as SRF resources.

25. **In sum, after over 50 years of evolution, the Fund has at its disposal a large array of facilities:**

- **Some of these fall under the heading of general policies that the Fund must adopt**. According to Article V, Section 3 (a), the Fund must "adopt policies on the use of its general resources, including policies on stand-by or similar arrangements". These policies are those that govern the use of resources in the credit tranches in order to help resolve a member's general balance of payments problems. In fulfillment of this mandate, the Fund has adopted decisions defining the circumstances and conditions under which members may request purchases from the Fund in order to solve a general balance of payments problem—notably, policies on stand-by arrangements.

- **Others fall under the heading of special policies the Fund has chosen to adopt that allow credit tranche resources to be used in order to address a special balance of**

payments problem. Article V, Section 3 (a) also specifies that the Fund "may adopt special policies for special balance of payments problems." The Fund policies regarding the first credit tranche, emergency assistance, Currency Stabilization Funds, and the use of Fund resources for DDSR operations fall under this heading.

- **Still others fall under the heading of special policies the Fund has chosen to adopt outside the credit tranches, which are designed to address special balance of payments problems.** These policies are often termed "facilities." The CFF, EFF, SRF, and CCL fall under this heading.

26. **The Fund's financial assistance can also be classified in other ways. For the purposes of the present paper, it is convenient to distinguish between three broad classes of facilities**—even though the resulting classification, on the one hand, groups together facilities with different legal standing, and, on the other hand, can involve assigning a single facility to several categories, depending on the way in which it is used:

- **Outright purchases**, which do not involve phasing and therefore are not conditional on future policy performance (although "tranching" is sometimes used, see below). These include the first credit tranche,[26] emergency assistance for natural disasters and post-conflict cases, and CFF purchases that are not made in conjunction with an arrangement.[27] [28]

- **Core facilities involving upper credit tranche conditionality**, featuring phasing. The Fund's core facilities can be considered to comprise stand-by arrangements, extended arrangements, the SRF, and the CCL.[29]

- **Other facilities involving upper credit tranche conditionality**, which are available only to members that have stand-by or extended arrangements, and which are designed to deal

---

[26]Purchases in the first credit tranche can be outright purchases or (nowadays more typically) can be made in the context of stand-by arrangements, but are not phased.

[27]The paper classifies as "outright purchases" all purchases that are not made either under an arrangement or in conjunction with an arrangement. (Strictly speaking, all purchases under the CFF are outright purchases, as they are not made under an arrangement.)

[28]Although outright purchases can also still be made, in principle, in the upper credit tranches outside the framework of emergency assistance, there have been no such purchases since 1968, and this paper will not consider them further.

[29]The classification of facilities with upper credit tranche conditionality as "core" and "non-core" is necessarily a matter of judgment. The judgments incorporated here are further explained in Chapters III and IV below.

with specific contingencies or events. These comprise Currency Stabilization Funds, support for DDSR operations, and the CFF when it accompanies an arrangement.[30]

Table 1 provides a summary of the instruments, and of their key features, under each of these headings.

II. Members and their Use of Fund Resources

27. **The Fund has become a nearly universal institution, and there is considerable diversity among the members that make use of the GRA** (Table 2). Of the Fund's 182 members:

- 23 are classified as industrial countries. None of these has made use of Fund resources since 1983;

- 80 are low-income countries that are eligible for the PRGF, but of these, 32 have made purchases or received arrangements from the Fund in the GRA in the last decade.[31] The relatively large number of PRGF-eligible countries making use of the GRA typically either (i) have not yet been able to elaborate a comprehensive structural adjustment program, as required under the PRGF, or (ii) do not have a balance of payments need (the PRGF is not available on a precautionary basis);[32]

- 79 are other developing and transition countries. Of these, slightly over half (44) have made purchases or received arrangements in the GRA in the last decade. The increasing globalization of capital markets is reflected in the fact that most of these 44 members (39) also had at least some access to capital markets.[33]

---

[30]Outright purchases under the CFF are subject to the higher access limits (as they are if they are made in conjunction with an arrangement) if the member's policies meet the standards of upper credit tranche conditionality. Because they are not phased, such purchases are classified under the first heading above.

[31]Of these 32 members, 25 also used ESAF/PRGF (or SAF) resources in the 1990s. A total of 54 countries had a total of 94 (three-year) arrangements under the ESAF in the 1990s.

[32]There have also been a few "blend" cases, namely cases where members have simultaneously received an extended arrangement and a PRGF arrangement.

[33]For want of a better definition, this paper counts a country as having access to capital markets if it has applied for a credit rating or has issued sovereign bonds. By this definition, only 4 of the 32 PRGF-eligible countries that have entered into purchases or arrangements in the GRA in the last decade have access to capital markets.

Table 1. The Fund's Facilities[1]

Facility	Conditionality		Maturity			Rate of charge		Balance of payments need		Within access limits?[2]
	Low	High	Short	Medium	Long	Normal	High	Potential?[3]	Type	
1. Outright purchases										
First credit tranche								Yes	Any	Yes
Emergency assistance: natural disasters								No	Natural disaster	Yes
Emergency assistance: post-conflict								No	Post-conflict	Yes
Stand-alone CFF								No	Temporary export shortfall/cereal import excess	No
2. Core facilities with upper credit tranche conditionality										
Stand-by arrangements								Yes	Any	Yes
Extended arrangements								Yes	Structural maladjustments	Yes
SRF								No	Capital account crisis, any	No
CCL								Yes	Capital account crisis, contagion	No
3. Non-core facilities with upper credit tranche conditionality										
CFF in context of arrangement								No	Temporary export shortfall/cereal import excess	No
CSF								Yes	Exchange rate-based stabilization	Yes
DDSR								No	Commercial bank debt reduction	Yes

[1]Nonconcessional only.
[2]Refers to the access limits under the credit tranches and the EFF. Yes if access under the policy counts toward these access limits, no if it does not.
[3]All policies are available for an actual balance of payments need (of the type specified). Some are also available on a precautionary basis, for a potential balance of payments need; these are indicated by "Yes" in this column.

Table 2: Countries making purchases in the GRA between 1989 and 1999

	Number of countries	Arrangements (SBA/EFF)			All policies	
		Number	Total approved (SDR billion)	Total drawn (SDR billion)	Total approved (SDR billion)	Total drawn (SDR billion)
Total	76	182	136.6	74.9	149.1	87.5
Non-PRGF eligible	44	131	128.6	70.7	138.7	80.8
of which:						
Developing	27	74	93.4	54.5	99.4	60.6
of which,						
SRF type drawings 1/	...	5	51.8	36.0	51.8	36.0
Precautionary at approval	...	16	8.0	1.1	8.0	1.1
Total non-precautionary, non-SRF	...	53	33.6	17.5	39.6	23.5
Least Developed	--	--	--	--	--	--
Transition	17	57	35.2	16.2	39.3	20.2
of which,						
SRF type drawings 1/	...	1	8.5	3.1	8.5	3.1
Precautionary at approval	...	8	0.7	0.2	0.7	0.2
PRGF eligible	32	51	8.0	4.2	10.5	6.7
of which:						
Developing	14	28	7.2	3.7	9.3	5.8
of which,						
SRF type drawings 1/	...	--	--	--	--	--
Precautionary at approval	...	2	0.7	--	0.7	--
Least Developed	9	13	0.4	0.2	0.6	0.4
of which,						
Precautionary at approval	...	4	0.0	--	0.0	--
Transition	9	10	0.4	0.2	0.6	0.2
of which,						
SRF type drawings 1/	...	--	--	--	--	--
Precautionary at approval	...	--	--	--	--	--

1/ SBA s with Mexico (1995), Thailand (1997), Indonesia (1997), Korea (1997) and Brazil (1998); the extended arrangement with Russia (1998). In the case of Russia only the augmentation to the original 1996 extended arrangement and the CCFF has been considered SRF type.

28. **The stand-by arrangement under the credit tranche policies remains by far the Fund's most utilized instrument (Table 3), but with use of extended arrangements increasing in recent years.**[34] Of 182 arrangements approved in the 1990s, over four-fifths were stand-by arrangements. The 1990s saw a revival of the EFF (which had been little used in the mid- to late 1980s), reflecting in part a growing recognition of the need for longer term structural adjustment programs to deal with the underlying, growth-inhibiting problems many members confronted. There was a further increase in the use of the EFF starting in 1996, largely by the transition economies,[35] and, as a result, half of the arrangements in place as of end-1999 were extended arrangements. Perhaps paradoxically, increased use of extended arrangements under the EFF coincided with a revival of longer stand-by arrangements: after approving no stand-by arrangements of 24 months or longer for a decade from 1986 onward, the Fund granted seven such arrangements between 1996 and 1999.[36]

29. **The Fund's other facilities have been used less extensively.** The Systemic Transformation Facility was used 17 times in the 1990s, and the policy on DDSR operations and emergency assistance for natural disasters and post-conflict cases around 10 times each.[37] There were 39 purchases under the CFF (and one under the contingency element of the then-CCFF) in the 1990s, most of them (31) in the first half of the decade.

30. **At any one time, the Fund has only a moderate number of arrangements in place in the GRA, and a good number of these arrangements are precautionary, so that the number of members making purchases under arrangements is smaller still.** As of end-1999, only 10 percent of the Fund's members were drawing GRA resources under arrangements. There were 28 stand-by and extended arrangements in place—which was on the high side for the 1990s,[38] in part as a reflection of the financial turmoil of the last few years (members with arrangements included Argentina, Brazil, Indonesia, Korea, Mexico, the Philippines, and Thailand). Ten of these arrangements were precautionary, including four

---

[34]Henceforth, references to "arrangements" in this Chapter should be read as "arrangements in the GRA."

[35]Of the 18 extended arrangements approved since 1996, 8 have been for transition economies. Apart from these countries, use of the EFF would have remained relatively steady over the last 10 years.

[36]These seven include four SRF-type cases, see footnote 40 below. Long stand-by arrangements had been more common prior to 1986. Nonetheless, the average period of stand-by arrangements has been increasing slowly over the decades, from 12 months in the 1950s and 1960s to 14-15 months in the 1980s and 1990s (and 18 months in the second half of the 1990s if SRF-type cases are included).

[37]The cases of emergency assistance for post-conflict cases, which was established in 1995, were all in the second half of the 1990s.

[38]Between 1990 and 1998 (at the end of the financial year in April), the number of arrangements in place ranged between 19 and 29 (IMF Annual Report, 1999, Appendix II).

Table 3: Use of facilities between 1989 and 1999 1/

	SBA	EFF	CCFF	DDSR	STF	Emergency Assistance		SBA	EFF	CCFF	DDSR	STF	Emergency Assistance	
						Natural disasters	Post-conflict						Natural disasters	Post-conflict
	Number 2/							SDR billion approved						
Total	148	34	39	11	17	8	7	92.2	44.4	8.5	3.1	0.3	0.7	0.1
Non-PRGF eligible	104	27	30	10	11	3	--	86.1	42.5	6.5	3.1	0.1	0.4	--
of which:														
Developing	57	17	18	8	--	3	--	67.8	25.6	2.8	2.8	--	0.4	--
Least Developed	--	--	--	--	--	--	--	--	--	--	--	--	--	--
Transition	47	10	12	2	11	--	--	18.3	16.9	3.7	0.3	0.1	--	--
PRGF eligible	44	7	9	1	6	5	7	6.1	1.9	2.0	0.1	0.1	0.3	0.1
of which:														
Developing	23	5	4	1	1	3	--	5.5	1.7	1.9	0.1	0.0	0.2	--
Least Developed	12	1	3	--	--	2	4	0.3	0.1	0.1	--	--	0.1	0.04
Transition	9	1	2	--	5	--	3	0.3	0.1	0.1	--	0.1	--	0.05

1/ GRA only
2/ In the case of SBAs and EFFs this refers to the total number of arrangements; for the CCFF, Emergency Assistance for natural disasters and post-conflict cases it refers to the number of purchases (tranched purchases have been counted as a single purchase); for the DDSR this refers to the total number of occasions that the Fund has supported commercial bank debt restructuring operations in the context of an arrangement.

extended arrangements (two of which had been precautionary from inception, and two of which became precautionary after approval).[39] Of the 182 arrangements approved during the course of the 1990s, about one in six was precautionary (at inception).

31. **Developments in the volume of Fund financing have been episodic** (Figures 1 and 2). Sharp increases following the oil shock of the 1970s and the debt crisis of the 1980s were later mostly reversed.

32. **A surge in lending in the 1990s was associated with transition and, later and to a greater extent, with crises of capital market confidence.** Of total commitments under arrangements in the whole of the 1990s, over 40 percent was to members affected by capital account-driven crises, or "SRF-type" cases—Mexico (1995), Thailand (1997), Indonesia (1997), Korea (1997), Russia (1998), and Brazil (1998).[40] Another fifth of the commitments were to transition economies, leaving less than 40 percent for what might be called the Fund's "ordinary" financing (non-transition, non-SRF). In part reflecting the fact that a relatively large proportion of these arrangements was precautionary, this group was ultimately responsible for drawing about 30 percent of the total amount drawn under all arrangements in the 1990s.

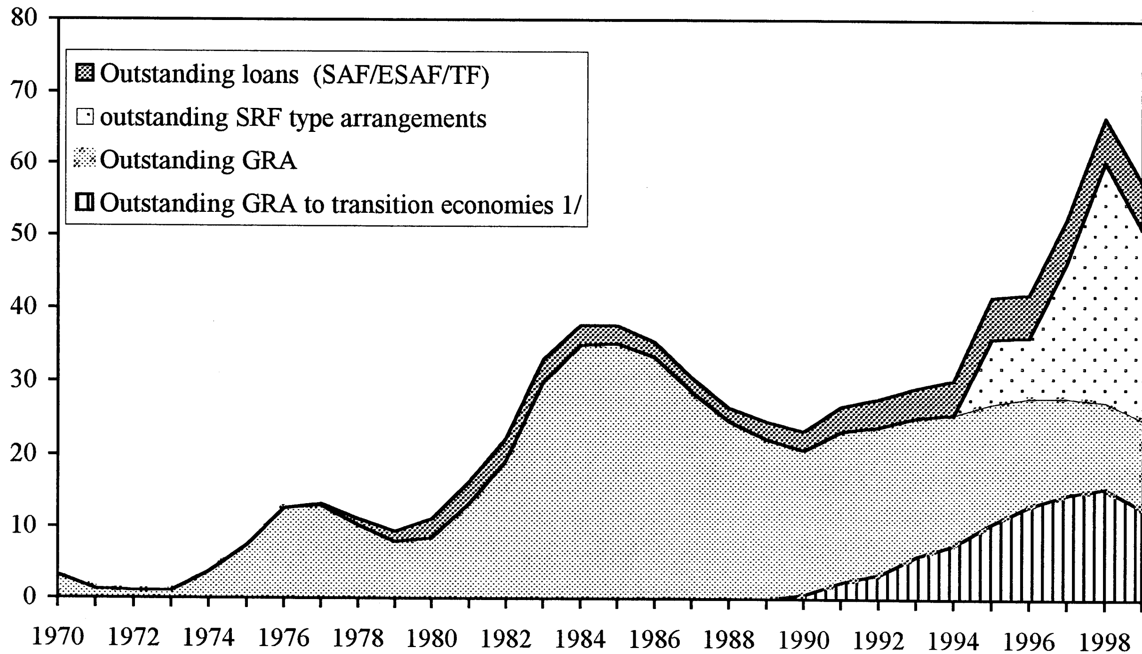
33. **At the same time, the access levels approved for stand-by and extended arrangements have, in general, remained well within access limits** (Figure 3)**, and the great majority of members remain well within the cumulative limit** (Figure 4). For most

---

[39]There have been eight extended arrangements that were precautionary on approval since the EFF was created in 1974, half of them since 1996.

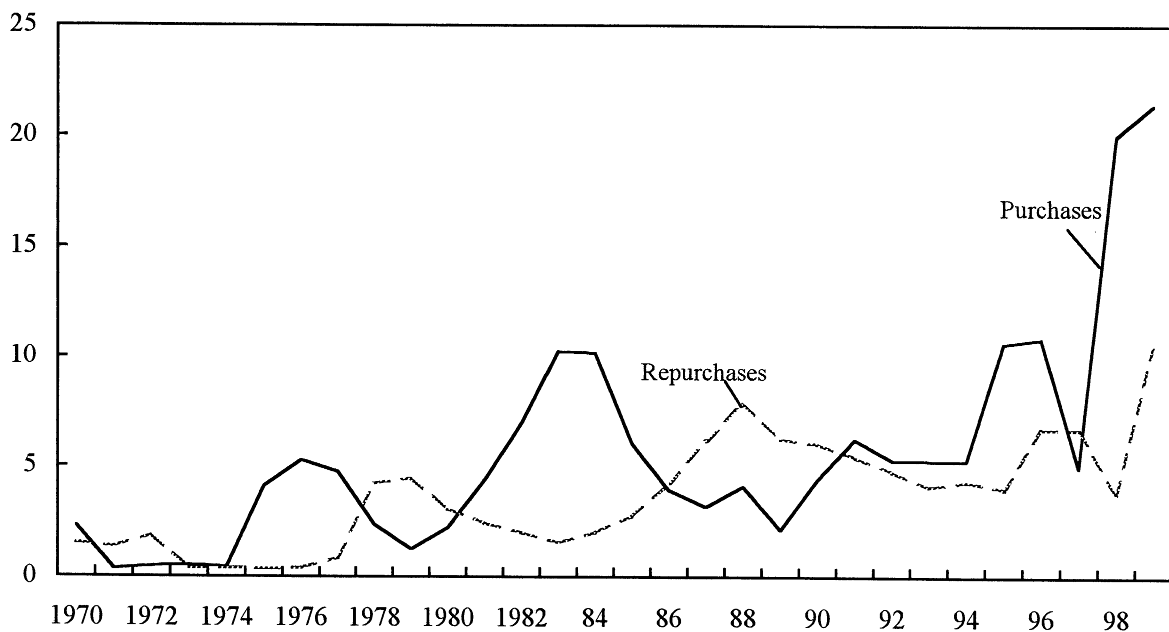
[40]See Chapter I for the purposes and features of the SRF, which is now the Fund's instrument for lending to members suffering this type of crisis. The term "SRF-type cases" is used because some of these cases predated the establishment of the SRF. Among the latter cases, only cases where the access limits were exceeded are called "SRF-type;" for instance, the augmentations of the arrangements for Argentina (1995) and the Philippines (1997) are not included. At the time of the crisis in Russia (July 1998), the Fund did not approve a new arrangement but augmented an existing one, and accordingly only the augmentation of the arrangement, as well as the CCFF purchase granted to Russia at this time, is included in the totals for SRF-type cases. (The CCFF component is included on the assumption that access under the SRF would likely have been higher if Russia had not qualified for the CCFF.) In the case of Indonesia, the 1997 stand-by arrangement was approved (in November 1997) at 490 percent and augmented (in July 1998) to 557 percent of (old) quota, and the latter amount has been included in the totals committed for SRF-type cases. The stand-by arrangement was subsequently replaced by an extended arrangement; as of end-1999, Indonesia had purchased the equivalent of 498 percent of quota under the combined arrangements, which (being less than 557 percent of quota) has been included in the total purchases for SRF-type cases. The Russian CCFF purchase and the Indonesian purchases that were subsequently transferred to the extended arrangement (including those under the July 1998 augmentation to the stand-by) together amount to SDR 6 billion, out of a total of SDR 39 billion drawn in SRF-type cases.

Figure 1. Evolution of Fund credit and loans outstanding, 1970-99
(calendar year basis)



1/ This does not include the SRF type component for Russia.

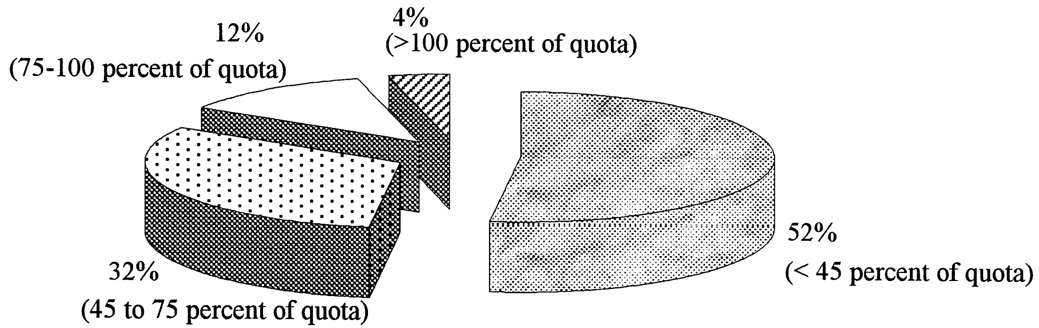
Figure 2. General resources purchases and repurchases, financial years ending April 30, 1970-99 (in billions of SDRs)



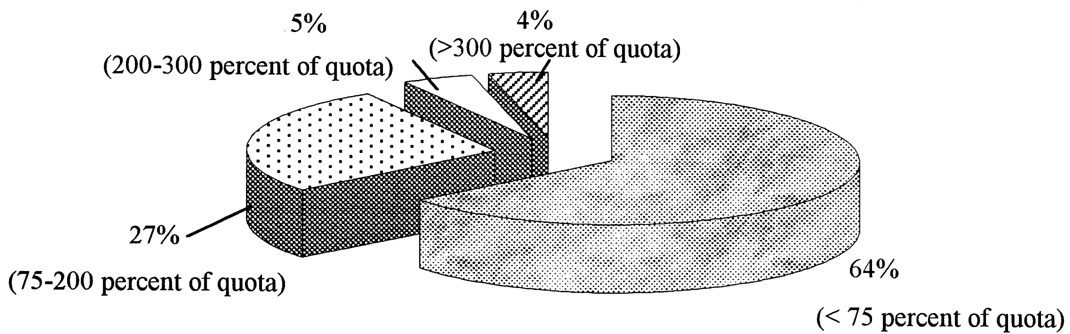
Source: Treasurer's department

Figure 3. Access levels for arrangements in the GRA, 1989-99 1/

Percent of arrangements within given ranges of annual access levels
(in percent of quota)



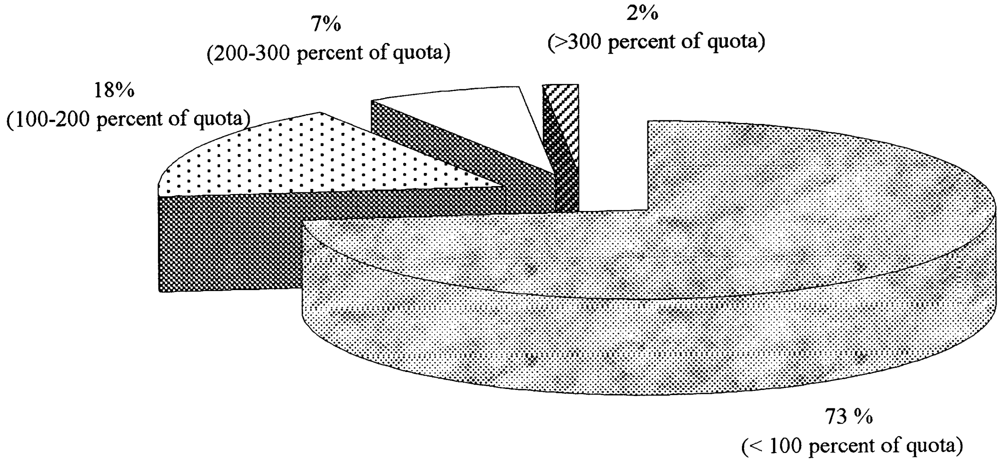
Percent of arrangements in given ranges of cumulative access levels
(in percent of quota)



Source: Staff estimates

1/ Quotas in place at the time of approval of each arrangement.

Figure 4. Percentage of members with outstanding GRA resources within given ranges 1/
(in percent of quota, as of end-December 1999)



Source: Staff estimates.

1/ Excludes arrears cases.

of the last decade, the annual access limit under the credit tranches and the EFF has been set at 100 percent of quota, and the cumulative limit at 300 percent of quota.[41] Yet more than half of all arrangements approved over this period had annual access levels of less than 45 percent of quota, and only 4 percent of all arrangements (comprising mainly the SRF-type cases) had annual access levels exceeding 100 percent. Similar patterns are evident for cumulative access approved under each arrangement. Of members that have GRA resources outstanding (and excluding arrears cases), almost three-quarters had less than 100 percent of quota outstanding as at end-1999.

34. **Precautionary arrangements typically have still lower access than other arrangements, although recently there have been a few with access well above average.** Precautionary arrangements have typically featured access in the range of 30-60 percent of quota (cumulative over the course of the arrangement), reflecting the absence of an apparent need, and consistent with the fact that the access provided could be used to finance fully a shock to which the appropriate response might include adjustment.[42] (The measurement is cumulative because the cumulative amount of access would be available for this purpose by the end of the arrangement.) In recent years, however, the Fund has granted a few precautionary arrangements with much higher cumulative access (Argentina, 1998, 150 percent of quota, and the Philippines, 1998, 161 percent of quota).[43]

35. **With moderate access levels, the Fund's share in the financing needs of borrowing members has remained relatively low.** This is true even if financing needs ("gross financing needs," or GFN) are calculated abstracting from the need to roll over short-term debt, and would be even more so if short-term debt were taken into account.[44] Excluding

---

[41]The annual limit was 100 percent of quota except for 1992-94, when it was 68 percent of quota (and there was a dual limit of 90-110 percent of quota up to 1992, with the applicable limit depending on the seriousness of the member's balance of payments need and the strength of its adjustment effort). The cumulative limit was 300 percent of quota except up to 1992, when it was 400-440 percent of quota.

[42]In contrast to non-precautionary arrangements, where the origins of the need are known and the balance between financing and adjustment agreed as part of the program, in a precautionary arrangement, the need, if it materializes, may come from any source. If the precautionary arrangement is small, it will not be possible for the member to finance fully more than a small need; if the need that materializes is large, the Fund and the member would most likely enter into negotiations on a possible augmentation of the arrangement, including on the desirable balance between adjustment and financing.

[43]The Board is scheduled to consider a precautionary arrangement of 255 percent of quota for Argentina on March 10, 2000.

[44]GFN is defined as the sum of the current account deficit (excluding official transfers) and amortization on medium- and long-term debt (including Fund repurchases and repayments), as well as reserve accumulation and clearance of arrears. "Augmented" gross financing need would take account also of the need to roll over short-term debt, but reasonably reliable data to calculate this have not been available until quite recently.

SRF-type cases, the share of Fund financing in members' GFN has averaged between 9 percent and 15 percent every year for arrangements approved in the 1990s.[45] If transition cases are also excluded, the share falls to an average of 9 percent for the decade as a whole. In individual cases, the share of Fund financing to GFN rarely exceeds 20 percent. Cases where the share has gone higher comprise almost exclusively the transition cases, where it has on occasion reached 30–40 percent, and SRF-type cases, where it has sometimes reached 30-50 percent (but where it would fall substantially if short-term debt were taken into account).[46]

36. **There are not many members that purchase Fund resources (in the GRA) year after year** (see Annex IV). In a slight departure from the definitions that the Fund has used in the past (which focused on the number of arrangements members had), a "prolonged user" is here defined as a member that effectively made purchases for more than 5 out of the last 15 years, with outstanding use of Fund resources currently in excess of 100 percent of quota (indicating that the member has continued to use Fund resources relatively intensively in recent years). The present definition thus excludes periods of time when arrangements were precautionary, and periods when the programs supported by the arrangements were off track and no purchases were made.[47] Although there are 28 countries that had *arrangements* in the GRA for more than 5 of the last 15 years, only 7 of these countries *made purchases* for more than 5 years.[48] Of these, only 4 countries had outstanding Fund credit in excess of 100 percent of quota at end-1999; and three of these members had moved to precautionary arrangements prior to the onset of the financial crises of the late 1990s.[49]

---

[45] These numbers are calculated *ex ante*, based on program projections, and are simple, unweighted averages of country-by-country ratios.

[46] For SRF-type cases, which were all heavily frontloaded, the figures quoted relate only to the first 12 months. For other arrangements, the figures relate to the entire period of the arrangement.

[47] The length of effective use is not affected (that is, it remains equal to the length of the arrangement) if purchases within the arrangement are delayed relative to their originally scheduled dates but are eventually made.

[48] This exercise is somewhat biased against finding that transition economies are "prolonged users." These countries have been engaging in structural reform that could be supported by the Fund for at most a decade (and many of them have been members of the Fund only since the early 1990s), and thus, compared with other members, it is less likely that they will have had an effective duration of use of Fund resources of five years in the period under review. At the same time, the Fund expected to support transition on a sustained basis for some time, so the presence of "prolonged users" among the transition economies would not be surprising or, necessarily, a cause for concern.

[49] The diminished problem of prolonged use of Fund resources in the 1990s, compared with the 1980s, also reflects the establishment of the SAF/ESAF, which many of the Fund's poorer members began to use in the second half of 1980s in place of GRA resources. The data in this paper do not include use of SAF/ESAF.

37. **There are, however, many members that have had a succession of (non-precautionary) arrangements from the Fund, even though they did not consistently purchase, because their programs went off track.** To some extent, this was also the phenomenon that underlay the prevalence of "prolonged use" observed in earlier studies, which did not distinguish between arrangements and periods of purchases under arrangements. While there are only 7 countries that purchased Fund resources for more than 5 of the last 15 years, there are an additional 12 that had arrangements for more than 5 out of 15 years, but whose programs went off track, so that they effectively made purchases for less than 5 years. (Out of the earlier identified 28 members that had arrangements for more than 5 out of 15 years, there are an additional 9 members that fall below 5 years of effective purchases because their arrangements were in part, or entirely, precautionary.)

III. A Possible Simplification of the Structure of Facilities

38. **As it embarks on a review of its facilities, one of the issues the Fund needs to confront is whether the present structure of facilities is unduly complex.** Excessive complexity makes the Fund's operations more difficult for both members and the public to understand. In any case, as would be expected and as is evident from Chapter II, members make much less use of the more specialized facilities than of the core facilities. The present chapter will discuss in turn policies on outright purchases and the non-core facilities involving upper credit tranche conditionality, with a view to facilitating Board consideration of whether some of these might be eliminated.

A. Outright Purchases

39. **The Fund has in place four facilities that can provide support in the form of outright purchases**: the first credit tranche policy, emergency assistance for natural disasters, emergency assistance for post-conflict situations, and the Compensatory Financing Facility (CFF). Regarding the latter, this section will consider only the stand-alone element, that is, outright purchases under the CFF where no arrangement is in place (CFF purchases where arrangements are in place will be considered in the next section).

40. **These facilities share the feature that resources are typically provided in a single purchase, with no commitment of resources or phasing of purchases conditional on future policy performance;** [50] **but the lower conditionality implicit in the absence of phasing does not mean lesser safeguards for the Fund.** As with all use of Fund resources, requests for purchases can be granted only if the member is moving toward a resolution of its balance of payments problems, consistent with the purposes of Fund financing, and if the Fund

---

[50] Tranching of total resources is sometimes used, whereby (at least) two outright purchases are provided. Tranching differs from phasing, which covers purchases under one arrangement, insofar as the outright purchases are not conditional on prespecified policy performance.

is assured that the member will be able to repay. In the case of outright purchases, the balance of payments problems at issue are in most cases considered more tractable than those for which upper credit tranche conditionality is applied, and the assurance of repayment is based on an assessment that the member will find solutions, in cooperation with the Fund, for its balance of payments problems. In addition, a relatively low level of conditionality—compared with transactions under the upper credit tranches—is warranted by the fact that the maximum amount of Fund financing available is relatively small (25 percent of quota under the first credit tranche and, normally, under emergency assistance, and a maximum of 55 percent of quota under the stand-alone CFF).

41. **For each kind of outright purchase, the case for lower conditionality rests on different considerations, and the requirements vary accordingly:**

- **The first credit tranche** is available only to members that have no or little outstanding use of Fund resources, and provided that the member itself is making reasonable efforts to solve its problem. The latter is normally demonstrated in a letter of intent, and the Fund also typically expects the member to take prior actions. The first credit tranche differs from other outright purchases in that it is available for any balance of payments need, and not for a specific type of need. Its availability shows good faith on the part of the Fund, and builds a constructive basis for subsequent negotiations of an arrangement with upper credit tranche conditionality, if that becomes necessary.

- **Emergency assistance for natural disasters** also requires the member to describe its policies.[51] Relatively low conditionality in this case is warranted by several considerations. First, the shock the country has undergone is exogenous, and does not have its origins in inappropriate policies. Humanitarian considerations also weigh in the balance, as there is typically a desire to assist the affected country at a reasonably early stage, even if it cannot elaborate a complete program quickly. While such considerations might lead the Fund to accept a slightly higher degree of risk to its resources than it would otherwise, it is notable that there have been no cases of arrears on emergency assistance.

- **Emergency assistance for post-conflict cases** is made available only if the member intends to request an arrangement from the Fund under the upper credit tranches or the EFF within a relatively short time frame, and again requires the member to describe its economic policies. Tranching of total resources (see footnote 50) can be, and has been, used to help ensure the effective use of Fund resources, and provide an incentive to develop a comprehensive program, thereby increasing the safeguards on the use of these resources. In this case, the assessment that the member will be able to repay is predicated

---

[51] In about two-thirds of the cases of emergency assistance for natural disasters since 1982, outright purchases were followed within a year or so by an arrangement from the Fund, underscoring the member's commitment to adjustment in most cases.

on the seriousness of the authorities' intention to develop a comprehensive plan, which they are unable to do immediately only because—according to one of the criteria for access—institutional and administrative capacity has been disrupted as a result of the conflict. As with emergency assistance for natural disasters, humanitarian considerations weigh in the balance too.

- **An outright purchase under the CFF** rests on the premise that low conditionality is appropriate in cases of temporary current account shocks (and the CFF is alone among the policies on outright purchases in not typically requiring a statement of the member's policies).[52] However, recognition that, even where a shock is temporary, some adjustment will still be required in most cases led the Board in January 2000 to voice strong sentiment for confining the stand-alone CFF (namely, the CFF outside the context of an arrangement) to cases where the balance of payments position is deemed satisfactory apart from a temporary export shortfall or cereal import excess. Such cases are rare: no country that has requested access to the CFF since 1988, when the present system of access limits was introduced, has been found to belong in this category. In any case, even for countries that have no other balance of payments problems, it may be difficult in practice to distinguish between temporary and permanent shocks, and temporary shocks may be less common than was supposed in the past.[53]

42. **In all these cases, it is also relevant to consider the degree to which the alternative to Fund financing would be financing from private capital markets.** The Fund's attitude toward requests from members with access to capital markets will be considered in Chapter IV below, but it is clear that, in creating special policies and facilities, the Fund has been motivated primarily by the objective of preventing "excessive" adjustment, rather than lowering members' borrowing costs. In some of the cases that qualify for outright purchases—post-conflict cases in particular—the member is unlikely to have much access to capital markets. When the member does have access, it may have little interest in the relatively small amounts of resources typically available under the policies on outright purchases.

[52]See "Review of the Compensatory and Contingency Financing Facility and Buffer Stock Financing Facility—Preliminary Considerations," EBS/99/222, December 9, 1999, for a full discussion of the CFF. As noted above, the access limits for outright purchases under the CFF vary depending on whether the member's policies are judged to satisfy the standards of upper credit tranche conditionality, but—absent an arrangement in the upper credit tranches—this judgment in itself is a very difficult one.

[53]See Cashin, Liang, and McDermott (1999) "How Persistent are Shocks to World Commodity Prices", IMF Working Paper WP/99/80.

Nonetheless, the CFF, with its somewhat higher access limits, may be subject to the concern that members are using it to some extent to substitute for private financing.[54]

43. *In this light, Directors may wish to express their views on the following suggestions:*

- *retaining the policies on the first credit tranche and emergency assistance for natural disasters and post-conflict cases;*
- *eliminating stand-alone purchases under the CFF for countries with other balance of payments problems, as was discussed in January 2000;*
- *retaining the possibility of a stand-alone CFF purchase for countries with no other balance of payments problems only if the CFF itself is to be retained as a facility (see Section B below).*

B. Non-Core Facilities with Upper Credit Tranche Conditionality

44. **The Fund has in place three facilities that provide financing in conjunction with arrangements, and which are designed to deal with specific contingencies and events:** Currency Stabilization Funds (CSF), the (non-stand-alone) CFF,[55] and mechanisms to support commercial bank Debt and Debt Service Reduction (DDSR) operations. The common philosophy underlying these mechanisms is that members' specific balance of payments problems and needs are sometimes best dealt with by using specific, tailored policies with their own rules, rather than relying only on the Fund's upper credit tranche policies.

45. **There are a number of reasons why the Fund may continue to prefer establishing such mechanisms to deal with problems as they come up.** These relate primarily to creating a transparent expectation of additional access (be it beyond the access limits or above average access) under certain conditions, sequestering funds unless specific circumstances materialize, imposing additional conditionality or eligibility requirements, possibly applying maturities different from those of the underlying arrangement, and finally reasons related to public relations. It could be that the approach of creating (possibly temporary) special mechanisms will continue to serve the Fund and its members well as new problems and issues emerge.

---

[54]The recent staff paper (EBS/99/222) noted that it is, by and large, middle income members that have been using the CFF in recent years. According to the classification in the present paper (see footnote 33), over 80 percent of the purchases made under the CCFF during 1989-99 were made by countries with access to capital markets.

[55]Henceforth references to the CFF, unless otherwise indicated, are to be read as references to the non-stand-alone CFF, that is, the CFF in the context of an arrangement.

46. **At the same time, it is important to recognize that there may be costs associated with a larger number of facilities,** especially in terms of complication and hence a lack of transparency vis-à-vis both members and the public. At a minimum, therefore, when it considers creating new facilities in future, the Fund should be satisfied that the problem to be addressed cannot equally well or better be addressed through the existing facilities.

47. **At present, there may be a case for elimination of all the existing non-core facilities**. This case rests on a combination of design features and changes in the world economy that have, or perhaps should have, made the instruments fall into disuse:

- **The CSF (established in 1995) has not been of much interest to members, and has become less relevant in today's economic environment.** Its maturity is much shorter than that of the credit tranches; its release provisions are demanding and complex, and allow the Fund wide discretion; and it is within the access limits under the credit tranches. In addition, the CSF rests on the premise that members may have an unusually high need for reserves in the early stages of an exchange rate-based stabilization, for confidence purposes. As the dangers of adjustable pegs have become more evident and enthusiasm has grown for more flexible regimes (or more rigid regimes like currency boards), the notion that discretionary intervention may be an appropriate response to pressure in an exchange rate-based stabilization effort has become more questionable. The CSF has not been used in the five years since its creation.

- **The Fund's policy on support for DDSR operations (established in 1989) proved useful, but has probably become obsolete.** It was notable in particular for its "sequestration" provisions (ensuring that only satisfactory agreements with commercial banks were given support), and evidenced the Fund's support for commercial bank debt reduction in resolving the debt crisis of the 1980s. However, there has been only one arrangement involving Fund support for DDSR since 1995 (Cote d'Ivoire, in 1998, using ESAF resources). The Board noted in 1997 that "…this phase of the evolving approach to dealing with the debt crisis that erupted 15 years ago is drawing to a close. The remaining cases of commercial bank debt to be dealt with are a small residual." This is even more the case today, and the policy seems no longer relevant or needed.

- **The CFF presents a less clear-cut picture.** Most of what it does can be achieved through the credit tranche policies, though not (i) the additionality of its access outside the access limits applicable to arrangements, (ii) the way its maturity remains consistent with the relatively short-term nature of the balance of payments need, regardless of the type of arrangement in conjunction with which CFF resources are provided,[56] nor (iii) its

[56] As noted in EBS/99/222, relatively short maturity resources are likely to be appropriate for a temporary current account shock, even in a country with more protracted balance of payments problems. Replacing the CFF with an expectation that arrangements will be augmented in the event of export shortfalls or cereal import excesses of the

(continued…)

repurchase provisions in the event of overcompensation. Indeed, arrangements are often augmented to address exogenous shocks. At the same time, retaining the CFF for use in conjunction with arrangements implies clear additionality in the case of ongoing arrangements, since set additional amounts would be made available in the event of specified current account shocks, when the appropriate response to such shocks could actually consist of a different mix of financing from the Fund, financing from elsewhere, and adjustment. The introduction of phasing of CFF purchases, which the Board favored in its discussion in January 2000, would go some way toward allowing the Fund to influence this mix.

48. *Directors may wish to express their views on the following suggestions:*

- *eliminating the CSF;*

- *eliminating the policy on Fund support for commercial bank DDSR operations;*

- *either (i) eliminating the CFF in its entirety, or (ii) adopting a streamlined CFF along the lines described in EBS/99/222 (see Annex V) for a period of, say, two years, at which time it could be reviewed again in the light of experience and of developments in other facilities. If the latter route is chosen, there would seem to be no reason to treat the cereal import element (which currently needs to be extended periodically) any differently from the export shortfall element (see EBS/99/222), and both elements might therefore be made subject to the same review provisions.*

IV. Some Fundamental Issues

49. **As part of the debate on reform of the global financial architecture, it is opportune for the Fund to reexamine its core facilities—i.e., those involving arrangements** (including, for the purposes of this discussion, the upper credit tranche policies, the EFF, the SRF, and the CCL). Several recent developments and critiques make this reexamination timely. First, the second half of the 1990s has seen the advent of "21st century crises"—large-scale crises of capital market confidence. The first section of this chapter will discuss the role of the Fund in these crises. In so doing, it will examine the Fund's newest facilities, the SRF and the CCL, in turn. Second, some have expressed concern that the Fund, in the context of its "ordinary" financing, may be providing financing to too many members and for too long. In this connection, the second section of this chapter will discuss, in turn, financing for members with ongoing access to capital markets, financing for extended balance of payments difficulties that are seen to be so *ex ante*, and (unexpectedly) prolonged use of Fund resources. It will then outline some policies (in particular, with regard to the rate

---

type currently financed under the CFF would result in longer maturity resources being provided to members with extended arrangements.

of charge, repurchase periods, and conditionality) that could be expected to affect the extent and duration of Fund lending.

50. **By way of preamble, it is useful to recall the functions of conditionality, which are to balance safeguards for the Fund with assurances to the member of the availability of resources.** The phasing of purchases conditional on prespecified policy conditions—characteristic of arrangements—ensures both that the Fund will be assured that the member is making progress toward overcoming its balance of payments problem, and that the member knows that it will be able to purchase if it meets certain conditions.

51. **As a safeguard to the Fund,** conditionality in general—and *a fortiori* the relatively high conditionality associated with phasing—serves two critical purposes:

- **A first purpose is to safeguard the Fund's resources.** Through conditionality, the Fund seeks assurances that the member will be able to repay.

- **A second purpose is to provide assurances that the Fund's financing is being used to help a member overcome its balance of payments problem,** consistent with the purpose of Fund financing.[57]

52. **In addition, the Fund's ability to withhold resources if policy conditions are not satisfied should bring other important benefits**:

- **Conditionality helps members implement sound policies, and, if it produces the intended results, should secure not only benefits for the member but also positive externalities for the global economy.** There is some evidence that Fund-supported programs are generally successful in stabilizing the economy.[58] While it has become increasingly accepted that "ownership" by the authorities is a critical factor determining whether programs are implemented and succeed (so that one might question whether conditionality brings any useful changes in a member's policies),[59] the need to specify conditionality for Fund financing ensures a close and continuous dialogue between the

[57]The latter purpose of conditionality is a reason why collateral could not function as a substitute for conditionality (although the Articles foresee that it could be used as a complement in certain cases), since collateral alone would not provide the assurance that Fund financing was being used to lay the basis for a member's return to external viability.

[58]See the survey by Ul Haque, Nadeem and Mohsin Khan (1998), "Do IMF-Supported Programs Work? A Survey of the Cross-Country Empirical Evidence," IMF Working Paper WP/98/169, December 1998.

[59]See, e.g., the Chairman's Summing Up, "Distilling the Lessons from the ESAF Reviews," EBM/98/73: "Directors endorsed, above all, the notion that national ownership of the program greatly improved the prospects for sustained implementation."

Fund and a member, and allows the Fund to bring its experience and influence to the country's agenda and to foster domestic support for sound policies.

- **Conditionality should support the catalytic role of the Fund,** at least by assuring other creditors that the Fund has done its own "due diligence," and, to the extent that it affects policies, by strengthening the country's ability to repay *all* its creditors. Conditionality should thereby play an important role in helping members gain, regain, or strengthen access to capital markets, and in making future Fund financing less likely.[60]

A. Crises of Capital Market Confidence

(i) The resolution of crises

53. **The most prominent development in the Fund's financial operations in the last decade has been the advent of large-scale financing for crises of capital market confidence.** As shown in Chapter II, this has been quantitatively by far the most important development of the 1990s, and it is certainly the one that has attracted the most publicity. With increasing globalization and capital account liberalization, and notwithstanding the efforts now underway to make the international financial architecture less crisis-prone, it is also perhaps the development that holds the greatest implications for the future. This section takes stock of the debate and developments in this area. Specifically, what is the role of the Fund in capital account-driven crises, how do the policies the Fund has designed in this area—in particular, the SRF—help it achieve its purposes, and what are the considerations that must be borne in mind in examining their design?

54. **The Fund's Articles were framed with an eye particularly on the current account, yet the global economic environment has evolved in ways that make volatility in the capital account at least an equally important potential threat to prosperity for many members.** When the Articles were written, it was a common, and fair, assumption that private capital flows would be fairly limited (or controlled), and that disturbances to a member's capital account could be isolated (possibly through the use of controls) from having significant effects on the member's current account, and thus on national and international prosperity. Experience has shown that, in the modern financial system, such isolation and neutralization of capital account shocks is not feasible. In the Mexican and Asian crises, disturbances to the capital account induced large and sudden shifts in current accounts and had dramatic effects on trade and economic activity.

55. **Fund support of members undergoing capital account-driven crises thus fits squarely within the purposes of the Fund**. Although the amounts of Fund support in cases

---

[60]See, e.g., Bird, Graham, and Dane Rowlands (1999), "The IMF's Role in Mobilizing International Capital: Is There a Catalytic Effect?," paper presented to Claremont-Georgetown Workshop on Improving the Credibility of IMF Programs, Georgetown University, January 2000, for questions as to the practical significance of this effect.

like the Mexican and Asian crises have been controversial, there is a widespread consensus that the availability of Fund (and other) financing helped contain what would otherwise have been still higher costs both for the countries involved and more widely—for their region and for the world economy as a whole. Moreover, absent the availability of Fund support in such situations, members might well be more hesitant about opening their capital accounts—and there is a consensus that (careful and appropriately sequenced) capital account liberalization brings benefits both to the country involved and to the world economy. The Fund's role in these crises thus exemplifies ways in which it can help members avoid "measures destructive of national and international prosperity", as well as "give confidence to members" that appropriate support will be available for members that accept the risks of more open policies. Although Article VI prevents the use of Fund resources to meet a large or sustained outflow of capital, the Fund's interventions in capital account-driven crises have been aimed precisely at staunching the outflow of capital, through sound policies.

56. **Provision of Fund financing in these cases does, however, raise important issues of moral hazard**. The knowledge that Fund financing is likely to be available in a crisis could result in countries continuing to borrow, and international capital markets continuing to lend, in the face of an unsustainable fiscal and external position and other excessively risky policies.

57. **Moral hazard is a logical consequence of the availability of Fund financing, and indeed of any form of insurance.** The point at issue is whether the potential costs imposed by moral hazard are in practice such that they risk outweighing the benefits of the availability of Fund financing.

58. **It is difficult to get a handle on the practical significance of moral hazard.** The observed fact that some investors avoid losses when the Fund intervenes in a capital account-driven crisis does not necessarily mean that these investors are being "bailed out" by Fund financing. Investors may instead be reaping the benefits of conditionality, which can help establish sustainable policies and catalyze private funds. In any case, Fund lending is not large enough to provide a very large element of transfer to the country,[61] or to suggest a guarantee of debt service, even in SRF-type cases.[62] Clearly, despite large-scale Fund support, many investors—in equity and long-term debt in particular—did take severe losses in the recent

[61]This would be true even assuming significantly worse performance in repayment to the Fund than has been the case in the past—see Jeanne, Olivier and Jeromin Zettelmeyer, "International Bailouts, Domestic Supervision, and Moral Hazard," forthcoming IMF Working Paper.

[62]See Lane, Timothy and Steven Phillips, "Moral Hazard in IMF Financing," forthcoming IMF Policy Discussion Paper.

crises. Overall, empirical work finds little evidence of the practical importance of moral hazard.[63]

59. **Nonetheless, any Fund financing will always bring with it at least the risk of moral hazard, and the Fund has been working to minimize this effect** through its efforts to involve the private sector in the resolution of crises. Among many unresolved issues are the questions of *how much* Fund financing is appropriate in cases where members suffer crises of confidence—and how much private sector involvement should be sought. These are issues that will clearly need to be considered further as work on private sector involvement, and other key aspects of the debate on the international architecture, proceeds.

60. **After dealing with the first "21st century crises" through stand-by arrangements in the upper credit tranches, in 1997 the Fund established the Supplemental Reserve Facility for the specific purpose of providing financing in these circumstances.** The establishment of a separate facility was motivated by the notion that these crises might require very large-scale financing, beyond normal access limits, and that terms different from those of the credit tranches would be appropriate in such cases, given the likely short-lived nature of these crises, the scale of Fund support provided, and the moral hazard risks that could arise. To some extent, the SRF resembles the lending facilities of a domestic lender of last resort (LOLR), à la Bagehot,[64] although there are important differences relating to the fact that the borrower is a sovereign.[65] Key features of the SRF include:

- **The absence of access limits.** Because moral hazard is a particularly difficult problem in the case of sovereign lending, the lack of specific limits does not necessarily mean that the Fund will lend "freely" (in the manner of a domestic LOLR), but rather that the Fund retains the flexibility to determine access on a case-by-case basis.

- **Short maturity (1 - 1 ½ years, with some flexibility to extend this range).**[66] Members using SRF resources are expected to regain access to capital markets quickly, and thus to

---

[63] See Nunnenkamp, Peter (1999) "The Moral Hazard of IMF Lending: Making a Fuss About a Minor Problem?", Kiel Discussion Paper 332, Kiel Institute of World Economics; and Lane and Phillips, op. cit.

[64] Bagehot, Walter, "Lombard Street: A Description of the Money Market," 1873.

[65] In particular, the domestic LOLR's device for sorting the insolvent from the merely illiquid—the reliance on collateral—is not available to the Fund, because it does not provide the assurances required that the Fund's resources are being used to support adjustment (see footnote 57). In addition, collateral may be less effective as a sorting device for sovereign borrowers than it is for banks, since a sovereign's balance sheet tells a relatively small part of the story about its solvency, with prospects (e.g., for output growth) and political considerations (i.e., willingness rather than ability to pay) playing large roles.

[66] Note that these maturities, and also the surcharge on the rate of charge, apply to the SRF resources alone, and that SRF resources are provided under stand-by or extended arrangements together with credit tranche or EFF

(continued…)

be in a position to repay the Fund quickly. The exact maturity of the SRF was the subject of extensive discussion at the Board in 1997, and the shortening of maturity appears so far to have been appropriate. In two of the three SRF cases thus far (Korea and Brazil), repurchase expectations were met on or ahead of schedule.[67] It is true that in SRF cases, where the ability to repay depends in part on volatile capital markets, there is considerable uncertainty as to when the member might be able to repay. If a turnaround does not materialize quickly enough for the member to meet the repurchase expectations, the Fund has the flexibility to extend these by up to one year. Conversely, if a turnaround materialized much more quickly than is implicit in the current repurchase schedule, the relatively high rate of charge on SRF resources (see below) should constitute an incentive for the member to repurchase early. The early repurchase policy might also come into play in these circumstances (see below).

- **A substantial surcharge on the rate of charge**. This too was the result of extensive discussion at the Board. Like the penalty rate charged by a domestic LOLR, the SRF surcharge is intended to limit borrower moral hazard (since members might take excessive risks if they knew that they could borrow cheaply if a crisis struck). Like the short maturity, the surcharge also reflects the fact that members using SRF resources are expected to regain access to capital markets quickly, and are expected to repay the Fund when they do so. It is thus important that the rate of charge on SRF resources not create opportunities for arbitrage—the more so given the possible magnitude of Fund support in these cases. Since SRF resources are provided at a time when access to capital markets is essentially cut off, the rate of charge on SRF resources is still much lower than the (presumably extremely high) rate the markets would charge, if credit from the markets were available at all in such a situation.

61. **There is a tension between, on the one hand, the fact that crises that threaten significant contagion are more costly for the world economy than others, and, on the other, the need for the Fund to treat its members uniformly.** Even if it were possible to distinguish clearly between cases that risk triggering systemic crises and cases that do not, it would not be legally possible, as some have suggested, to limit the availability of certain Fund facilities to the former cases, because it would not be consistent with the requirement of uniformity of treatment.[68] Inevitably, however, in helping a particular member overcome its

---

resources, so that the resulting terms are really hybrid. The main rationale for this construct is that members must be allowed the use of the credit tranches for any balance of payments need.

[67] In the case of Russia, the expectations were also met on schedule, although the program under which the SRF purchase had been made had gone off track.

[68] See, e.g., the suggestions in "Safeguarding Prosperity in a Global Financial System—the Future International Financial Architecture," Report of an Independent Task Force Sponsored by the Council on Foreign Relations (1999), Council on Foreign Relations, New York.

balance of payments problem, the Fund seeks to ensure that the member's crisis will not spill over into other countries.[69]

62. *Directors may wish to comment on the importance they place on the problem of moral hazard, whether the SRF appears to be fulfilling an important role, and whether there are any elements of the SRF they believe need review.*

(ii) The prevention of crises

63. **In the debate on the international financial architecture, the prevention of crises of capital market confidence has rightly attracted as much attention as the means for their resolution. In this context, the question has naturally arisen whether the Fund's facilities could be better used to foster prevention.** The availability of Fund financing for capital account-driven crises may in itself help prevent crises: the knowledge that Fund support is likely to be available—on certain conditions—may go some way toward offsetting the tendency of creditors to "rush for the exit" in a particular case (as long as no formulaic rules were imposed for the involvement of the private sector). But the Fund should be able to do more than this in individual cases, in particular to encourage the adoption of sound policies.

64. **Some have gone so far as to suggest that the Fund should provide financing *only* to members who have followed sound policies in the past** (including by adhering to the new internationally-accepted standards).[70] Such a restriction on the Fund's financial operations would not be consistent with the Articles, which give members the right to expect that the Fund will assist them if they commit themselves to policies that promise correction of their difficulties. In addition, the possibility of dynamic inconsistency has to be recognized: it might be useful to *threaten* not to provide financing, if that threat causes members to strengthen their policies, but carrying out the threat after a crisis has broken out could imply significant damage not only to the member but also to the world economy as a whole.

65. **Nonetheless, some form of special Fund commitment to members following sound policies would bring benefits.** A link between *ex ante* sound policies and the availability of Fund support in a possible crisis can help reduce the risk of liquidity crises by signaling the Fund's confidence in the member and providing it with a precautionary line of defense, and can encourage members to adopt sound policies (including, in time, relevant internationally-accepted standards). Moreover, such a commitment by the Fund should not

---

[69] In the SRF decision, the Fund has recognized that "this facility is likely to be utilized in cases where the magnitude of the outflows may create a risk of contagion that could pose a potential threat to the international monetary system."

[70] See, e.g., Calomiris, Charles (1998), "Blueprints for a New Global Financial Architecture," American Enterprise Institute.

lead to an unduly high risk of moral hazard, since the loss of "constructive ambiguity" about the availability of Fund financing may be offset by the addition of *ex ante* policy requirements (which can also include appropriate arrangements to involve the private sector in the event of a crisis).

66. **The Fund has two instruments that are capable, at least in principle, of fulfilling this function—the Contingent Credit Lines, but also precautionary arrangements in the upper credit tranches.** The CCL, created in May 1999, has not yet been used by any member. Precautionary arrangements, by contrast, have been in use for decades. Although in the past they have typically been small, as noted in Chapter II, the Fund has recently allowed some precautionary arrangements to be larger, with the effect of better protecting members against shocks of the magnitude that might ensue from a loss of access to capital markets.

67. **It seems appropriate to reflect on the similarities and differences between the CCL and precautionary arrangements.** Since the CCL has not proved attractive to members thus far, and since precautionary arrangements embody some of the features that were thought to be desirable in the CCL, the design of the CCL might benefit from a comparison with precautionary arrangements—and the same might also be true *vice versa.*

68. **The CCL and precautionary arrangements differ in three main ways**, with corresponding merits and drawbacks:

- **Compared with the CCL, precautionary arrangements provide a greater degree of assurance to the member that resources will be available if needed.** Stand-by arrangements were developed in the 1950s precisely as precautionary lines of defense. Their structure—whereby rights to draw accrue, and are maintained, as conditionality is satisfied—is relatively well-suited to provide the member with the assurance that it will be able to purchase if the need arises.[71] By contrast, under the CCL, the Fund may require additional policy actions (in the activation review) before it releases any funds beyond a first, small purchase. The Fund thus protects itself against purchases by a member that is not adjusting its policies as required by the crisis, but this construction also reduces the assurance given to the member that it will be able to draw. It may also affect the interpretation of the CCL by the markets. Although a commitment of resources under the CCL harbors a presumption that the resources will indeed be released, markets may fear

[71] Conditionality in precautionary arrangements is not thereby without problems. On the one hand, there is the risk that, after the member has met all performance criteria for a particular test date, its program goes off track—but the member does not lose its rights to purchase until the next test date passes. On the other hand, there is the risk that a relatively trivial breach of a performance criterion (or a breach that follows from precisely the kind of shock that the arrangement was designed to protect against) will interrupt the member's right to purchase. Both these risks are present in a non-precautionary arrangement, but their effect is magnified in a precautionary arrangement by the prior accumulation of rights to purchase that the member did not exercise: it is *all accumulated* rights to purchase that the member risks retaining or losing inappropriately.

that the Fund could be led to signal a higher degree of confidence in the member's policies than it actually has—in the knowledge that it has some leeway to withhold release of its resources at the critical time.[72]

- **Unlike the CCL, precautionary arrangements in the upper credit tranches do not allow for a sharp differentiation between members with "first class" policies and members whose policies require adjustment, and it might be difficult to make them do so.** The CCL is subject to strict eligibility criteria, and (subject to the caveats above, and to the fact that its signaling effect has not yet been tested) access to it should therefore provide a clear signal of the strength of members' policies. Conditionality in the CCL is thus to some degree assessed only *after the fact*: the member is granted a commitment of resources based on its prior policy performance. By contrast, in a precautionary arrangement, as in other arrangements and consistent with the desire to give the member the assurance that resources will be available on specified conditions, those conditions are specified *in advance*. It is possible to conceive of a precautionary arrangement that would be strongly frontloaded in recognition of the soundness of the member's past and current policies, but such an arrangement may still to some extent be seen by members to suffer from a "stigma" associated with stand-by arrangements (this despite the fact that the signal conveyed by a precautionary arrangement should in any case be one of strength, not weakness).

- **Again unlike in the CCL, it is not possible under a precautionary arrangement to restrict purchases to situations of balance of payments crisis.** CCL resources are released only upon completion of the activation review, which involves verification that a crisis of contagion has struck.[73] By contrast, precautionary arrangements allow the member to purchase for any balance of payments need, provided the program is fully on track. Thus, while the Fund might wish to grant the arrangement in order to protect the member from a crisis, it could not, as long as the member represents that it has a balance of payments need, prevent the member from drawing in the absence of a crisis—for instance, because of the low cost of Fund resources. This drawback of precautionary arrangements would diminish in importance if ways were found of reducing the incentives for members to draw under arrangements (see in particular the discussion of the rate of charge below).

---

[72]Members with which potential arrangements with CCL resources have been discussed have not typically pointed to this lack of assurance as a prime factor in their consideration of an arrangement with CCL resources, but they have consistently expressed concern that an arrangement with CCL resources might be misinterpreted by the markets (i.e., as a sign of possible trouble rather than a sign of strength).

[73]Because CCL resources are provided in the context of a stand-by arrangement, the member could access the credit tranche component for any balance of payments need.

69. **It is possible to imagine various future constellations of facilities with different emphases placed, respectively, on the CCL and precautionary arrangements.** The function of the CCL could be fulfilled either by the CCL itself or by large precautionary arrangements. In addition, precautionary arrangements could to some extent fulfill a function similar to the CCL on a smaller scale, for members still requiring some adjustments in their policies. The existence of the CCL will, however, in itself have an effect on how precautionary arrangements are perceived, as these arrangements will inevitably be seen as signaling policies of a quality insufficient for the CCL.

70. **In the immediate future, a first order of business in this area might be to amend the CCL, to see if it can in practice be made to serve the aims for which it was originally conceived.** The lack of appeal of the CCL thus far may reflect in part the current, relatively calm condition of world financial markets—although it was the intention that members would seek arrangements with CCL resources at just such times—and more generally the perception by members that might be considered eligible that they run very little risk of crisis. The lack of interest in the CCL also reflects in part the untested nature of the facility—in particular, the absence of a visible standard (members do not know what sort of "club" they would be joining), and the concern that markets may misinterpret an arrangement with CCL resources as a sign of weakness rather than strength. The Fund's demonstrated ability to respond quickly to members' requests when problems strike may also have dampened enthusiasm for a prearranged mechanism such as the CCL. Several members have also, however, expressed more particular reservations about the CCL, which point to a number of areas that the Fund might want to reexamine:

- **The rate of charge.** Members may see little reason to resort to the CCL, rather than the SRF, because the rate of charge on the two facilities is the same. The rates of charge were set to be the same because CCL resources, like SRF resources, were to be drawn during a financial market crisis, when countries face substantially higher costs of borrowing. However, because of its demanding *ex ante* policy requirements, the CCL could carry a lower charge than the SRF without creating excessive borrower moral hazard. Moreover, the important positive externalities from sound policies would also argue that the rate of charge on the CCL should be set significantly lower than that on the SRF. Since the activation review under the CCL ensures that significant amounts of resources are released only if a crisis of contagion strikes, the CCL is not greatly subject to the concern that members might purchase only because of the low cost of Fund resources, although the rate of charge (and, particularly, any progression therein with time) could potentially remain an important parameter creating incentives for quick repayment.[74]

[74] It is possible to argue that the maturity of CCL resources should be shorter than that of SRF resources, because CCL countries by definition have followed sounder policies than countries approaching the Fund for SRF resources, so that their problems could be expected to be even more short-lived. However, shorter maturities would risk reducing the attractiveness of the CCL relative to the SRF, and run counter to the objective of creating incentives through the CCL for members to follow sound policies.

- **The commitment fee.** Especially because they know they can approach the Fund, should a crisis hit, for access to the SRF, members may prefer not to pay the commitment fee (25 basis points)—especially as it is not refundable if purchases are not made. The present commitment fee is broadly comparable to that charged by private creditors in the few past cases of private contingent lines of credit. It would be legally feasible to reduce the commitment fee on CCL resources (or even to eliminate it, although this might not be advisable, as there are costs involved in tying up Fund resources).

- **The assurance given to the member under the CCL that it will be able to draw.** As noted above, the Fund's ability to require additional policy actions for "activation" if a crisis strikes may act both as a deterrent to members to request access to the CCL, and as a negative influence on the signal the Fund seeks to give by granting members such access. Drawing on the precedent of precautionary arrangements, there may be a case for reexamining the degree to which, in the CCL, the Fund could curtail its power to require policy adjustments should a crisis hit.

71. *Directors may wish to comment on the importance they place on use of the Fund's financing facilities (in particular, precautionary arrangements and the CCL) to encourage members in their efforts at crisis prevention, and on the relative merits and drawbacks of using the CCL or precautionary arrangements in this connection. For the immediate future, they may wish to indicate whether they believe further experimentation with the design of the CCL is worthwhile, and which elements—the rate of charge, the commitment fee, the Fund's discretion in the activation review, or other parameters—might best be reexamined in this regard. They may also wish to comment on the possibility of larger precautionary arrangements (which could be envisaged even as further experimentation with the design of the CCL is underway), and whether further moves in this direction might be linked to an increase in the rate of charge on such arrangements (see also below).*

B. Other Fund Financing

72. **As noted in Chapter II, although the rise in Fund financing in recent years is largely accounted for by capital account-driven crises, a very large majority of the Fund's financial operations remains of the more traditional type**—using the upper credit tranches and the EFF, rather than the SRF or CCL. Recent critiques have suggested that the Fund extends financing under these more traditional policies to too many members, and for too long. These critiques are driven by a combination of concerns—a desire to minimize the size of the Fund (and its potential to interfere with market forces), and a desire to safeguard the revolving character of the Fund's resources. The present section will outline these concerns in turn, and then discuss Fund policies that bear on them.

(i) Principles

Fund financing for members with ongoing access to capital markets

73. **Now that a growing number of members are able to turn to international capital markets to meet their financing needs, and to do so at reasonable cost, the question naturally arises under what circumstances Fund financial support to these members is warranted.**[75] If such Fund support substitutes for private financing, to what extent is it consistent with the Fund's purposes? To what extent should Fund financing be only a "last resort"?

74. **First, *as a legal matter*, the Articles provide answers to these questions: a member that has ready access to capital markets can still qualify for the use of Fund resources, whether or not it chooses to exploit such market access.** Article V, Section 3 states that members are "entitled" to use the Fund's general resources (up to 100 percent of quota) subject, *inter alia*, to the existence of a balance of payments need. Article V, Section 3 (b) (ii) explains that a member can demonstrate a balance of payments need through "its balance of payments or its reserve position or developments in its reserves" (any one of these elements is sufficient). In practice, the first of these elements is calculated by making a distinction between (i) "autonomous" transactions, which are undertaken for their own sake, and (ii) those other transactions that are undertaken by the authorities for the purpose of financing a balance of payments deficit or an increase in reserves. Therefore, to the extent that the authorities borrow from capital markets for the purpose of financing a balance of payments deficit, the member has a balance of payments need.[76] It also has a need if the authorities *could* borrow from capital markets for this purpose but choose not to do so, since potential borrowing from capital markets has no effect on the observed balance of payments deficit. In both cases, the Articles provide that the member may turn to the Fund because Fund financing—unlike borrowing from capital markets, which may be short-term, easily reversible, and costly—is well suited to "give confidence to members" (Article I (v)) as they engage in a process of adjustment.

75. **Nonetheless, even within this broad conception, the Fund has choices to make as to the degree to which it will encourage or permit members to use its resources.** For example, in connection with a particular policy, the Fund may establish, as a matter of policy, a criterion that a member that satisfies the requirement of need should in addition be making

---

[75] What is a reasonable cost is necessarily a matter of judgment. The concept is used here to differentiate between a situation where a member has ongoing access to capital markets, and one where the member has lost such access (or can obtain it only at an "unreasonable" cost). The latter situation was considered in Section A above.

[76] Note that by no means is all the country's borrowing from capital markets part of the "balance of payments need." Both the private sector's borrowing, and official borrowing undertaken for purposes other than balance of payments support, are autonomous transactions and go to reduce the balance of payments need.

efforts on its own part to meet this need when seeking recourse to the Fund. In addition, policies on the terms of Fund financing (especially the rate of charge, but also repurchase periods and policies on prolonged use, see below) have a direct bearing on the degree to which members will seek to use Fund resources in the presence of access to capital markets.

76. **Second, *as an analytic matter*, there are several reasons why the Fund might want members to make significant efforts of their own to meet their financing needs from private markets:**

- **When a member has access to capital markets, the alternative to Fund financing is much less destructive of prosperity than when it does not.** In these circumstances, the alternative is not immediate current account adjustment, with its potential implications for growth, but rather borrowing terms for the member that may be worse than those available from the Fund.

- **To the extent that members turn to the Fund instead of to private capital markets, the Fund is not supporting the development of international capital markets to the extent that it might.** This risk, however, is to an important degree the corollary of the Fund's function of "providing confidence to members." As a provider of insurance, the Fund inevitably risks providing insurance to members that could have obtained insurance elsewhere. In any case, and as is evident from its small share in member's gross financing needs (paragraph 35), the Fund's resources are very small relative to the magnitude of international capital markets.

77. **At the same time, there are reasons why the Fund might not want members to treat it only as a last resort.** While some of the relevant benefits flow primarily from the presence of an arrangement, rather than actual Fund financing, the provision of financing can act as an important incentive for members to request arrangements (including because the prospect of financing may help divergent forces in the political arena coalesce). Possible reasons why the Fund might want to encourage members to have recourse to it include the following:

- **A Fund arrangement imposes a discipline on policy-making that borrowing from capital markets does not. It can thus help the member attain stability and growth, and can bring important positive externalities for the world economy.** Indeed, the Fund has over the years resisted suggestions that it should introduce disincentives for members to seek recourse to it, and has rather expressed the position that "members should be encouraged to adopt corrective measures, which could be supported by use of the Fund's general resources [...] at an early stage of their balance of payments difficulties or as a precaution against the emergence of such difficulties."[77] The experience in the

[77]"Guidelines on Conditionality", Decision No. 6056-(79/38), adopted March 2, 1979, *Selected Decisions,* pages 137-139.

recent financial crises, in which in several key cases members approached the Fund only at a very late stage, adds strength to this position.

- **Access to Fund financing may help to catalyze private financing.** Strong policies enhance a country's repayment capacity, and the "seal of approval" of the Fund may in itself help assure creditors that policies are sound.

- **Fund financing also catalyzes official financing.** Where exceptional balance of payments financing is being sought from other official creditors (for example, Paris Club reschedulings), these have typically looked to a financing role for the Fund that goes beyond "last resort" financing, even if the member has access to private sources of financing.

78. **Although *a priori* one might fear that members might resort to Fund financing on a large scale even while they were able to secure financing from other sources at reasonable cost, in practice this does not generally seem to be the case:**

- **There are both incentives and disincentives for members that have access to private financing to use Fund resources, and it may be that, in some cases at least, the incentives outweigh the disincentives.** In deciding whether to come to the Fund for financial assistance, the most important disincentives facing members most likely relate to conditionality and to concern that coming to the Fund will be interpreted as a sign of policy weakness. At the same time, the low cost of Fund resources may constitute an incentive to draw, especially once an arrangement is in place, as well as an incentive not to repurchase ahead of time.

- **At the same time, it is not apparent that members are "substituting" Fund for private financing on a large scale.** Access limits restrict the amount of financing the Fund can provide (except under the SRF and CCL). As noted in Chapter II, Fund financing generally remains well within these limits, and the Fund does not usually contribute a large portion of members' gross financing needs.

79. *Directors may wish to comment on the degree to which they believe the Fund should encourage members to seek financing from capital markets, and on the weight they place on the various pros and cons in this regard. They may also wish to comment—based both on the role of the Fund, and on their assessment of the practical significance of "substitution" of Fund for private financing—on whether they believe the Fund has in practice provided about the right amount of financing, relative to their balance of payments needs, to members that have ongoing access to capital markets.*

Fund financing for members with ex ante extended balance of payments difficulties

80. **Another important issue relates to whether the Fund should be lending for extended balance of payments difficulties, and specifically for members that are**

expected, *ex ante,* to face extended difficulties—that is, to members that are expected to need to have Fund resources outstanding for a relatively long time.[78] The issue arises because it is not self-evident that lending for extended balance of payments difficulties is consistent with the revolving character of Fund resources.

81. **It is important to distinguish between members with *ex ante* and *ex post* extended balance of payments difficulties.** The Fund provides financing to the former at relatively long maturities, *in the expectation* that time will be needed for the envisaged strengthening of the external position. By contrast, members that *unexpectedly* experience prolonged balance of payments difficulties may not easily be in a position to repay the Fund when maturities fall due, and may end up having a series of successor arrangements. Both types of need can result in members having Fund credit outstanding for a relatively long time. But *ex ante* extended needs are needs which Fund policies have identified as an appropriate basis for Fund lending, while *ex post* prolonged needs are ones which the Fund might not have financed—without more decisive adjustment—had it known their true nature from the outset. In the Fund's parlance, the term "prolonged use of Fund resources" has usually been applied to unexpectedly prolonged balance of payments needs, and these are addressed in the next section.

82. **The Fund's policies are such that lending for *indefinite* balance of payments difficulties should not occur.** In particular, they are intended to ensure, *ex ante*, that the member's balance of payments will become sustainable, and that it will be able to repay the Fund when maturities fall due. Prior to committing resources to a member, the Fund seeks assurance of the member's capacity to repay. Fund-supported programs must yield "a strengthening of the balance of payments by the time the repurchases begin to fall due and of a sufficient extent to allow the member to make the repurchases without strain"[79]—that is, the member must not face indefinite balance of payments difficulties.

83. **Views may differ on whether the Fund's existing maturities are consistent with the revolving character of its resources.** The concept of "indefinite" balance of payments difficulties is not in practice a usable one, and the Fund must draw a line between what it considers to be "indefinite" and what it considers to be difficulties sufficiently temporary to warrant use of revolving resources. It has revealed its preferences in this regard through the setting of its longest maturities—at present, ten years.

---

[78]The focus here is on balance of payments difficulties generally, not the technical concept of "balance of payments need", which is a basis for purchasing Fund resources. A member with an extended arrangement, for instance, is expected to have a need to use Fund resources for only 3-4 years, but to have balance of payments difficulties that prevent it from repurchasing the entire amount for another ten years.

[79]"The Chairman's Summing Up at the Conclusion of the Discussion on Criteria for the Amount of Access in Individual Cases," December 2, 1983, *Selected Decisions,* page 215-222.

84. **Although ten-year maturities may seem long, it is sometimes desirable for adjustment to a balance of payments need to take place at a relatively slow pace.** Some shocks take longer than others to reverse themselves (if they ever do) or to correct, and some reforms take longer to formulate, implement, and bear fruit than others. At the same time, rapid adjustment to pressures on the balance of payments may bring excessive costs. This is especially likely to be the case when the pressures are large, or in lower-income countries (both because of their likely higher marginal utility of consumption and because their economies are typically less flexible on the production side). In these cases, if the country were to have to repay the Fund relatively quickly, it would need to take measures unduly destructive of prosperity to do so. Transition economies, and countries that are PRGF-eligible or a little above the income cut-off for PRGF eligibility, provide examples of members for which relatively slow balance of payments adjustment may be appropriate. Clearly, though, judgments as to what constitutes "relatively slow" adjustment can differ—ten years could be considered to be too long or even perhaps too short from this point of view. Moreover, it is often difficult in practice to differentiate between balance of payments needs that are likely to be brief or extended (see also the discussion of repurchase periods below).

85. **The catalytic role of the Fund also plays a part in this connection, and could exert pressure for the provision of Fund financing in cases of extended needs.** As noted in paragraph 77, official balance of payments support in particular, and to a lesser extent private financing, may depend to some extent on the presence of Fund financing (although the presence of a Fund arrangement—perhaps precautionary—might be most important, or even sufficient, in this regard). The Fund has decided that it would stand ready to grant members support on a limited scale in such cases even if "it is questionable whether a sustainable position not requiring exceptional finance can be achieved over the medium term," as long as sufficient external financing can be obtained for the program and there is "a clear prospect of the member making net repurchases with a view to restoring its credit tranche position, thus preventing the use of Fund resources acquiring a semipermanent character."[80]

86. *Directors may wish to comment on whether they consider ten-year maturities to be consistent with the revolving character of Fund resources. They may also wish to consider whether it is appropriate for the Fund, by way of catalyst, to provide financing in cases where a sustainable balance of payments position may not be achieved by the time repayments fall due, as envisaged under the current guidelines.*

Prolonged use of Fund resources

87. **It is also possible for prolonged balance of payments difficulties to arise unexpectedly, even though they were not foreseen *ex ante*.** When prolonged balance of payments difficulties arise *ex post,* and if members make repeated purchases over a long

[80]Ibid.

period of time, they become "prolonged users" of Fund resources. Since the initial arrangements should have been granted in the expectation that the member would be able to repay without additional Fund financing, prolonged use will occur, in general, either when a member suffers repeated shocks, or when Fund-supported economic programs are not as successful as initially envisaged.

88. **The issue of prolonged use has recently attracted a good deal of attention and criticism.** Much of this criticism points to the repeated use of Fund resources as evidence not only that Fund-supported programs are ineffective, but that they provide the financing that permits a country to delay required adjustment and contributes to the creation of an unsustainable debt problem.[81]

89. **The Fund too has been concerned about prolonged use, and has discussed the subject on several occasions in the last two decades.** While repeated shocks do occur, prolonged use has generally been seen as originating in inadequate adjustment. The Fund has taken the view that mechanical rules in this area—for instance, refusing to grant new arrangements after a certain period of use—would unduly constrain it in responding to members' legitimate needs,[82] and remedies tried have focused on access policy and program design. Outstanding use of Fund resources is one of the criteria used in formulating access under arrangements, and access for prolonged users tends to be guided by the desirability of reducing their outstanding use of Fund resources over time. In addition, when considering further Fund support for prolonged users, the Fund has made efforts to conduct comprehensive reviews of past programs and of the factors behind past slippages, and to condition further support on strong policy justification, including a frontloading of policy measures.

90. **The data do not suggest that prolonged use of GRA resources is now a widespread problem, but there may be an equally worrisome problem in the number of members with repeated Fund arrangements, and particularly in the significant number of programs that go off track.** As noted in Chapter II, there are only four members that have purchased GRA resources for more than five of the last 15 years and that currently have credit outstanding of more than 100 percent of quota. There is, however, a much larger number of members that have had repeated arrangements (28 with arrangements covering more than five of the last 15 years), although they did not effectively make purchases for more than five years. This in itself could be a cause for concern: members with a continuing program relationship with the Fund might become unduly dependent on outside support for their policy-making processes. Of definite concern is the fact that close to half of these 28 members

---

[81] See, for instance, Bandow, Doug, "The IMF: A Record of Addiction and Failure," in Bandow, D. and I. Vasquez (eds.), "Perpetuating Poverty," Cato Institute, 1994.

[82] See "The Chairman's Summing Up at the Conclusion of the Discussion on Criteria for the Amount of Access in Individual Cases," December 2, 1983.

were unable consistently to make purchases, because their programs went off track. Possible remedies for this latter problem are discussed in the section on conditionality below.

91. *Directors may wish to consider whether prolonged use of Fund resources is a serious problem, and whether policies need to be reexamined in this regard, or whether concern should focus more on programs going off track.*

(ii) Policies

92. **If the Fund considers that it is, or risks, lending to too many countries and for too long, there are a number of policies that it might reexamine.** These relate to the rate of charge (a key incentive affecting members' use of Fund resources), repurchase periods (a key parameter determining the length of time purchases remain outstanding), and conditionality (a key parameter for the speed of adjustment). These three policies will be examined in turn below.

The rate of charge

93. **The rate of charge is an important factor that may influence members' decisions whether and for how long to use Fund resources** (both by purchasing and by not repurchasing before the due date).

94. **Since it reflects market rates on essentially risk-free instruments, the GRA rate of charge is below the market rate faced by borrowing members, and, by itself, constitutes an incentive to use, and continue to use, Fund resources.** By way of counterargument, it could be noted that the cost of Fund resources, from the point of view of the member, may be higher than it appears, since some members may consider that, alongside the benefits of more orderly adjustment, conditionality also brings costs, particularly in the political realm. Indeed, many members prefer not to request Fund assistance at all. Nonetheless, the financial incentive to use Fund resources, rather than borrow elsewhere, is substantial (especially once a member has already received an arrangement): during the 1990s, the average spread over LIBOR faced by emerging market countries was some 300 basis points, and almost never dipped below 200 basis points.[83] A higher rate of charge could dampen this incentive. A higher rate of charge might also be justified from the point of view of members that do not have access to capital markets, for whom Fund financing incorporates an even larger subsidy element.

---

[83]The data refer to the weighted average spread on outstanding bond issues by emerging markets, and were obtained from Capital Data Ltd., Bloomberg, and the Bond, Equity and Loan database developed by RES. The spread quoted (which is relative to US Treasury bonds of equivalent, medium- to long-term maturity) is smaller than the spread relative to three-month US Treasury bill interest rates which enter into the calculation of the GRA rate of charge.

95. **A higher rate of charge could also be justified from the point of view of the allocation of limited Fund resources.** The membership as a whole sets limits on the size of the Fund, and thus on the resources it can make available to borrowing members. It can be argued that it is therefore appropriate to impose a shadow price on users of Fund resources, taking account of the way in which their use tightens the constraint on possible use of Fund resources by other members.

96. **At the same time, it is reasonable to argue that the appropriate rate of charge on Fund resources should not, in general, equal market rates:**

- **First, market rates sometimes fluctuate widely, with periods of market exuberance followed by sharp cutbacks in lending.** To the extent that such swings reflect market failures, the Fund has a role to play in counteracting them, rather than following them and exacerbating their effects.[84] Such market failures may be evident over time, with wide swings in the level of interest rates charged to all borrowers in a particular class (for instance, the sharp upswing in risk premia for all emerging markets following the Russian crisis of August 1998); or they may be evident for a single country, with market views of the country's condition capable of taking sudden and excessive turns for the worse or the better.

- **Second, the Fund does not need to charge the same rate as private creditors, because the probability that it will be repaid is much higher**, both because it is able to apply conditionality and because of its preferred creditor status. It is also relevant in this regard that the Fund is a cooperative institution, not a profit-making one.

- **Third, a subsidy element in Fund financial assistance could be justified in light of the positive externalities from such assistance**, since it constitutes an encouragement for members to come to the Fund and to pursue appropriate policies.

97. **The Fund could also consider differentiating the rate of charge—**although this would be a further reversal of the trend toward unifying rates of charge that had prevailed prior to the establishment of the SRF, and would reintroduce additional complexity into the structure of charges:

- **To the extent that it is concerned about members making unduly large use of Fund resources, the Fund could differentiate the rate of charge according to the amount of Fund resources outstanding.** Currently, there is no differentiation by amount, except insofar as SRF/CCL resources (which are provided, under the relevant conditions, once a member reaches the access limits) bear a higher rate of charge.

---

[84] See Masson, Paul R. and Michael Mussa, "The Role of the IMF—Financing and Its Interactions with Adjustment and Surveillance", IMF Pamphlet No. 50, for a detailed discussion of these market failures.

- **To the extent that it is concerned about unduly long periods of use, the Fund could consider differentiating the rate of charge according to the period of use.** Except in the case of SRF/CCL resources (which bear a surcharge that rises with time), the rate of charge is not currently differentiated in this way—either *ex ante*, in the form of a higher rate of charge on EFF than credit tranche resources, or *ex post*, in the form of graduation of charges according to the length of time resources have been outstanding.

98. *Directors may wish to comment on what they see as the major advantages and disadvantages of the current GRA rate of charge, and how they see the balance between these considerations. They may also wish to comment on whether they see a case for differentiation of the rate of charge according to the amount and/or length of time resources are outstanding.*

Repurchases

99. **The requirements for repurchases are another key parameter affecting the extent to which members make (continued) use of Fund resources.** These requirements include both the standard repurchase periods and the early repurchase policy. Within the former, two separate parameters can be identified—the final maturity, when repurchases are completed, and the date when repurchases begin.

100. **Abstracting from the SRF and CCL (Section A above), the Fund currently makes available resources with two different final maturities, each of which might be reexamined:**

- **Most resources** are to be repurchased within five years. The practice of requiring repurchases within this period evolved in the first decade of the Fund's existence, and it is possible to argue that changes in the world economy suggest that some members at least could repay the Fund sooner. For the increasing number of members with access to capital markets, adjustment should bear fruits more quickly now, through the intermediary of better market access. Yet it is also important to remember that not all members have access to capital markets, and that a five-year maturity is probably not too long for those members for whom adjustment must still produce its results primarily through the current account—including notably PRGF-eligible members, many of whom use GRA resources (see Chapter II).[85] In addition, the Fund does have the early repurchase policy (see below).

- **EFF resources** are to be repurchased within ten years. As noted above, whether this period is considered to be consistent with the revolving character of Fund resources is a

[85]Uniformity of treatment requires the same maturities for the credit tranches (and indeed within any given policy or facility) for all members.

matter of judgment. Yet it is certainly possible to argue that the Fund has a responsibility to assist members undergoing profound structural reform (for instance, transition economies), and countries that are PRGF-eligible or a little above the income cut-off for PRGF eligibility, for all of which a relatively long repayment period may be appropriate. In any case, it is for discussion whether the Fund has been sufficiently selective in identifying the cases that should qualify for such long maturities. As noted in Chapter II, there was an increase in the number of extended arrangements in the 1990s. To some extent members began to treat the EFF as a "badge of honor," focusing on its typically more demanding policy conditions in the structural realm; and stand-by arrangements were sometimes and in some regions seen as associated with crises. Especially with the development of longer stand-by arrangements, and the increased tailoring of the policy content of programs to the difficulties at hand, regardless of the policy being used, there may be a case for reining in use of the EFF and clarifying the criteria for its use (including its use, if any, on a precautionary basis).

101. **A separate issue concerns the time at which repurchases begin, which might also be reexamined.** Repurchases under stand-by arrangements begin 3 ¼ years after purchase, and for EFF resources, 4½ years after purchase. In each case, the grace period extends beyond the period of a typical arrangement (12–18 months for stand-by arrangements, three years for extended arrangements) (although not much beyond the maximum length of stand-by and extended arrangements, three and four years respectively). It could be argued that there is room for shorter grace periods, since external viability should normally be established by the end of the arrangement period. Graduated repurchases (rising over time) might also be considered in this connection.

102. **The Fund also has flexibility, under the early repurchase policy, to request a repurchase from members that show sufficient balance of payments strength—but that policy is not well adapted to the current economic environment.**[86] The proper tailoring of the standard maturities would become a somewhat less pressing issue to the extent that the Fund had a well-functioning early repurchase policy. The policy, however, exemplifies the difficulty of making judgments about balance of payments strength when an increasing number of members have access to capital markets. In order for early repurchases to be called for when members' access to capital markets strengthens, the policy would have to take account of members' *potential* access to capital markets, which they may or may not choose to exploit, and which is thus not captured in actual balance of payments data. Yet reliance on a judgment about members' potential access would risk undermining the rules-based nature of

[86]See Annex III for a description of the early repurchase policy.

the early repurchase policy, and creating both uncertainty for the member and risks for uniformity of treatment.[87]

103. **The Fund could consider making use of the device whereby repurchase *expectations* can be established on specified dates ahead of the dates of repurchase *obligations***, although it has not done so thus far outside the SRF and CCL (and CSF). Under the SRF and the CCL, repurchase expectations fall due a year before the corresponding obligations, and the Board has the power to extend the expectations by up to one year. There is an important difference between this mechanism and the early repurchase policy, in that the "burden of proof" is reversed. Under the SRF/CCL, an expectation to repurchase arises unless the member requests an extension and the Board approves it, whereas under the early repurchase policy no early repurchase expectation arises unless the Fund determines it.

104. **A further way in which the Fund might secure greater flexibility in setting the (effective) schedule of repurchases would involve erring on the side of brevity in repurchase obligations.** If, at the time repurchase obligations fall due, the member requires the continued use of Fund resources, it must justify purchases, based on a continued balance of payments need, in the context of a new arrangement. Shorter maturities would thus shift the burden of proof as to balance of payments need or strength to the member, and reduce the risk of continued use of Fund resources by members that would be able to repay. The mechanism would have the additional advantage that, in cases where there were continuing balance of payments difficulties, conditionality would apply for a longer period, since, in order to secure continued financing under a follow-up arrangement, a member would have to abide by the conditionality of that arrangement (see also below).

105. *Directors may wish to comment on whether they see a case for shortening the final maturities of the credit tranches and the EFF, and, if so, on the reasons for this. In addition, Directors may wish to comment on whether they see a case for shortening the grace periods on the credit tranches and the EFF. Directors may also wish to express views on how the early repurchase policy could be strengthened, and whether the Fund could usefully consider making more use of repurchase expectations that fall due before the respective obligations.*

Conditionality

106. **The critique that the Fund lends to too many members and for too long, and more generally the concern about the revolving nature of Fund resources, raises questions about conditionality.** This paper does not purport to address the much wider range of questions that could be asked in this area more generally.

---

[87] These are issues with which the staff has been struggling in trying to formulate improvements to the policy. Because, once they have made purchases, members are committed to abide by the terms of the Fund's early repurchase policy, this policy must be sufficiently clear that members know what to expect.

107. **Fund resources are exposed to particular risk after the end of an arrangement, and it is possible to think of ways to mitigate this risk.** Conditionality ends when an arrangement ends, even though the member's actions thereafter, and throughout the period when Fund resources remain outstanding, continue to put the Fund's resources at risk. Clearly, a continuing close dialogue with the member, by means of some form of post-program monitoring, is helpful in this respect. The consultation clauses in stand-by and extended arrangements provide that, through the period when purchases in the upper credit tranches or under the EFF are outstanding, members "will consult with the Fund from time to time, at the initiative of the government or at the request of the Managing Director, concerning [the member's] balance of payments policies." The Fund has not, however, set out criteria by which these clauses might be activated. In practice, post-program monitoring currently takes the form of close contacts between the staff and the authorities, including staff visits to the country, and of informal briefings to the Board, and its intensity depends on an informal judgment by staff and Board. In addition, as noted above, shorter repurchase periods could help establish longer-lasting conditionality, where there is a continuing need for use of Fund resources.

108. **Perhaps the most pressing issue in the area of conditionality relates to the fact that a number of members have had repeated arrangements from the Fund because their programs were not consistently implemented.** Where programs have not been particularly successful or have gone off track, there would seem to be a particularly strong case for a rigorous analysis of the reasons for the disappointing performance, and for upfront implementation of policy measures in new arrangements.

109. *Directors may wish to comment on the importance they place on post-program monitoring, and on whether they see a case for strengthening existing mechanisms in this respect. They may also wish to comment on how—where previous Fund arrangements have not been successful or have gone off track—to strengthen the Fund's efforts to assess the reasons for this and address them effectively, including through frontloading of policy actions.*

ANNEX I

Issues for Discussion

House-cleaning

Directors may wish to express their views on the following suggestions:

- retaining the policies on the first credit tranche and emergency assistance for natural disasters and post-conflict cases;
- eliminating stand-alone purchases under the CFF for countries with other balance of payments problems, as was discussed in January 2000;
- retaining the possibility of a stand-alone CFF purchase for countries with no other balance of payments problems only if the CFF itself is to be retained as a facility (see below);
- eliminating the CSF;
- eliminating the policy on Fund support for commercial bank DDSR operations;
- either (i) eliminating the CFF in its entirety, or (ii) adopting a streamlined CFF along the lines described in EBS/99/222 (see Annex V) for a period of, say, two years, at which time it could be reviewed again in the light of experience and of developments in other facilities. If the latter route is chosen, there would seem to be no reason to treat the cereal import element (which currently needs to be extended periodically) any differently from the export shortfall element (see EBS/99/222), and both elements might therefore be made subject to the same review provisions.

Renovation

Directors may wish to comment on the importance they place on the problem of moral hazard, whether the SRF appears to be fulfilling an important role, and whether there are any elements of the SRF they believe need review.

Directors may wish to comment on the importance they place on use of the Fund's financing facilities (in particular, precautionary arrangements and the CCL) to encourage members in their efforts at crisis prevention, and on the relative merits and drawbacks of using the CCL or precautionary arrangements in this connection. For the immediate future, they may wish to indicate whether they believe further experimentation with the design of the CCL is worthwhile, and which elements—the rate of charge, the commitment fee, the Fund's discretion in the activation review, or other parameters—might best be reexamined in this

regard. They may also wish to comment on the possibility of larger precautionary arrangements (which could be envisaged even as further experimentation with the design of the CCL is underway), and whether further moves in this direction might be linked to an increase in the rate of charge on such arrangements (see also below).

Directors may wish to comment on the degree to which they believe the Fund should encourage members to seek financing from capital markets, and on the weight they place on the various pros and cons in this regard. They may also wish to comment—based both on the role of the Fund, and on their assessment of the practical significance of "substitution" of Fund for private financing—on whether they believe the Fund has in practice provided about the right amount of financing, relative to their balance of payments needs, to members that have ongoing access to capital markets.

Directors may wish to comment on whether they consider ten-year maturities to be consistent with the revolving character of Fund resources. They may also wish to consider whether it is appropriate for the Fund, by way of catalyst, to provide financing in cases where a sustainable balance of payments position may not be achieved by the time repayments fall due, as envisaged under the current guidelines.

Directors may wish to consider whether prolonged use of Fund resources is a serious problem, and whether policies need to be reexamined in this regard, or whether concern should focus more on programs going off track.

Directors may wish to comment on what they see as the major advantages and disadvantages of the current GRA rate of charge, and how they see the balance between these considerations. They may also wish to comment on whether they see a case for differentiation of the rate of charge according to the amount and/or length of time resources are outstanding.

Directors may wish to comment on whether they see a case for shortening the final maturities of the credit tranches and the EFF, and, if so, on the reasons for this. In addition, Directors may wish to comment on whether they see a case for shortening the grace periods on the credit tranches and the EFF. Directors may also wish to express views on how the early repurchase policy could be strengthened, and whether the Fund could usefully consider making more use of repurchase expectations that fall due before the respective obligations.

Directors may wish to comment on the importance they place on post-program monitoring, and on whether they see a case for strengthening existing mechanisms in this respect. They may also wish to comment on how—where previous Fund arrangements have not been successful or have gone off track—to strengthen the Fund's efforts to assess the reasons for this and address them effectively, including through frontloading of policy actions.

ANNEX II

The GRA Rate of Charge, and Other Charges on the Use of Fund Resources

The GRA rate of charge

The GRA rate of charge applies to all use of Fund resources, except for SRF/CCL resources, to which a surcharge applies (see Boxes 9 and 10 in Chapter I).

At the beginning of each financial year, the IMF sets the rate of charge on the use of its resources (the GRA rate of charge) as a proportion of the weekly SDR interest rate with the aim of covering operational and administrative costs and achieving a target amount of net income to add to its reserves. The IMF's income position is reviewed at midyear to determine if there is a need to change the relation between the rate of charge and the SDR interest rate.

To strengthen its financial position against the consequences of overdue obligations, the IMF has adopted "burden-sharing" measures to distribute the financial burden of overdue obligations, including the cost of additional precautionary balances, between debtor and creditor members, through adjustments to the rate of charge and to the rate of remuneration. The resources so generated are refundable, under certain conditions, to the members that have paid additional charges or received reduced remuneration.

The SDR interest rate is determined weekly as a weighted average of interest rates on specific short-term domestic obligations in the money markets of the five countries whose currencies constitute the SDR valuation basket. The weights reflect the values of the currency amounts in the SDR basket, which is revised every five years. The interest rates and instruments are the yields on three-month Treasury bills for the United States, the United Kingdom, and France, the three-month interbank deposit rate for Germany, and the three-month certificate of deposit rate for Japan.

For 1999/2000, the GRA rate of charge is 113.7 percent of the SDR interest rate, with the proviso that any income in excess of the target would be used retroactively to reduce the rate of charge for the year. The average rate of charge on the use of IMF resources in the third quarter of 1999/2000 was 4.34 percent, before adjustments for burden-sharing. (Adjustments for burden-sharing eventually added 13 basis points to the rate of charge in 1998/99, the last year for which the adjustments have been completed.)

Service charge and commitment fee

In addition to the rate of charge:

All commitments under Fund arrangements are subject to a commitment fee of 25 basis points on the amount scheduled to become available over the next twelve months. The commitment

fee is refundable to the extent purchases are made. It is also partially refundable in the event of cancellation of the arrangement.

All purchases are subject to a service charge of 50 basis points payable at the time the purchase is made.

ANNEX III

Early Repurchases Under Article V, Section 7 (b)

Identifying members to repurchase early

Early repurchase expectations are established in the context of an assessment of the balance of payments and reserve position of members for the purposes of inclusion in the financial transactions plan (formerly called the operational budget) and the designation plan.[88] Specific indicators of external strength are used in this assessment to maintain a degree of consistency among members, but the strength of a member's external position is ultimately a matter of judgment. All relevant factors and data are considered, with particular emphasis on recent and prospective current account balances, competitiveness, and external debt indicators, especially those offering insights into the member's exposure to short-term liquidity strains. For members with outstanding use of Fund resources ("debtor members"), judgments must also be made on whether the external position has improved relative to the time of the last purchase, and on the extent and sustainability of the improvement.[89] Members are not expected to repurchase early until the quarter following the second full quarter after their last purchase.

Calculating the repurchase amount

The formula for calculating the early repurchase amount is driven by gross reserves—1.5 percent of reserves plus or minus 5 percent of the change in reserves over the most recent six months, subject to the constraints that this amount cannot exceed 4 percent of reserves in a quarter, or 10 percent of reserves over a year, and cannot reduce reserves below 250 percent of quota.

Meeting an expectation

Early repurchase expectations can be reduced, or extinguished altogether, to the extent that scheduled repurchases fall due during the quarter or the member has made advance repurchases; credit for advance repurchases lapses after five quarters. The remaining expectation can be met either through repurchases or through the use of the member's currency in transfers in the financial transactions plan.

Sanctions

---

[88]Decision No. 6172-(79/101), June 28, 1979, *Selected Decisions*, pages 319-321.

[89]Decision No. 6273-(79/158) G/S, September 14, 1979, *Selected Decisions*, page 301.

There are no sanctions prescribed for failure to meet an early repurchase expectation. The Articles foresee that, if a member failed to meet an early repurchase expectation, and after consultation with the member, the Fund could make a representation to the member to repurchase, which would convert the expectation into an obligation. (The Fund has not, however, adopted a policy to give effect to this.) Failure to meet a repurchase obligation would expose the member to a range of sanctions by the Fund, including ineligibility to use the general resources of the Fund, suspension of voting rights, and withdrawal from membership.

ANNEX IV

Prolonged Use of Fund Resources

1. **This annex briefly reviews the extent to which "prolonged use" of Fund resources in the GRA is evident since 1970, and looks more closely at developments in the last 15 years.** It does not consider use of resources under the SAF/ESAF/PRGF.

2. **The first difficulty is establishing a workable definition of prolonged use.** A number of critics have focused attention on the number of years a country has outstanding use of Fund resources. Under this definition, however, a country with only two annual arrangements spaced six years apart would be considered a prolonged user, because it would have resources outstanding to the Fund for 12 years. The argument becomes incongruous if the arrangements are extended arrangements spaced 13 years apart, which would imply that Fund resources would be outstanding for 26 years. For this reason, this appendix focuses on actual number of years in an arrangement.

3. **The definition of prolonged use in the Fund has evolved** over the course of three successive Board discussions in the last two decades. In 1984, prolonged users were defined as members "which have had four or more programs during the [last] decade and outstanding liabilities greater than 100 percent of quota at the present time." In 1986, prolonged use was defined as "continuously outstanding credit tranche positions in excess of 25 percent of normal maximum access for six years or more," and it was noted that all eleven of the countries that met this criterion had had at least five annual programs since 1976. The 1991 definition came again close to that used in 1984, as prolonged users were defined as "members with five or more annual Fund-supported programs in the previous ten years with outstanding liabilities in the credit tranches of 100 percent of quota or more."

4. **This appendix adopts a variation of the 1984 and 1991 definitions, taking account of periods where a country is not purchasing under an arrangement**, either because the arrangement is precautionary or because the program has gone off track. This is done by adjusting the actual length of each arrangement by the ratio of actual purchases to approved purchases (hence, for instance, an arrangement that remained precautionary throughout would not be reflected in the number of years that a country was effectively purchasing under an arrangement).[90] The length of time during which the country is actually purchasing is called the "effective" duration of the arrangement. For the period since 1970, countries are considered prolonged users if they have had effective arrangements for more than nine years and have resources outstanding of more than 100 percent of quota.[91] (If a

[90]This method will tend to overstate duration to the extent that arrangements are frontloaded.

[91]The cut-off of nine years was chosen in order not to understate the problem, because a number of countries had effective arrangements between nine and ten years.

country's outstanding use of Fund resources is below this threshold, the country is considered to have "graduated," even if it made some purchases in recent years). For the period since 1985, prolonged users are defined as countries that have had effective arrangements for more than five years and that have Fund resources outstanding of more than 100 percent of quota.

5. **The distinction between formal time and effective time in Fund arrangements leads to a significant revision in the number of members that have made prolonged use of Fund resources.** During 1970-1999 there were 20 countries with arrangements exceeding nine years, but only six countries that effectively made purchases for more than nine years. This, in part, reflects the fact that eight of the 20 countries had one or more precautionary arrangements. The remaining difference reflects programs that went off track and/or remained inactive for relatively long periods. Of the six members that effectively made purchases for more than nine of the last thirty years, only three qualify as "prolonged users" according to the definition above, in that they had access exceeding 100 percent of quota as of end-1999. The other countries have either not recently made purchases, or have had recent arrangements but with low access.

6. **A similar pattern holds for the 1985-1999 period**. Of the 28 countries with formal arrangements exceeding five years' duration, only seven had effective arrangements for more than five years. This reflects the fact that nine countries had precautionary arrangements for part of the time, reducing the effective time that they made purchases to below five years, and that 12 countries had programs that went off track and/or were cancelled to make way for a new arrangement, so that they were not able to complete a notable portion of the initial purchases approved. Of the seven countries that had effective arrangements for more than five years, only four have outstanding access exceeding 100 percent of quota and would be considered prolonged users according to the definition above. However, the recent financial market turmoil is the reason why three of these countries have made purchases in recent years.

ANNEX V

Possible Mechanics of an Amended CFF [92]

Eligibility would be determined as it is currently under the CFF. The new CFF would cover exogenous and temporary export shortfalls and cereal import excesses. The method of calculation for the shortfall/excess would remain unchanged.

Access to the CFF would be subject to a simplified, preferably a single, set of limits and would "float" with respect to the access limits applicable to the credit tranches and extended arrangements. Repurchase periods would be the same as for the credit tranches, as at present.

"Stand-alone" access to the CFF would be available only for members whose balance of payments position is satisfactory apart from the temporary export shortfall or cereal import excess.

Otherwise, access to the CFF would be available only in the context of an arrangement, and:

(a) CFF purchases would be phased according to the related balance of payments need and in alignment with the conditionality of the underlying arrangement. There would normally be at least two purchases.

(b) CFF purchases would be made in parallel with purchases under the arrangement. CFF purchases would be subject to program performance criteria and/or completion of a review just like purchases under the arrangement. If purchases under the program were interrupted, CFF purchases would be also.

---

[92] From "Review of the Compensatory and Contingency Financing Facility – Preliminary Considerations," EBS/99/222, December 9, 1999.