INTERNATIONAL MONETARY FUND

The Fund's Support of Low-Income Member Countries: Considerations on Instruments and Financing

Prepared by the Finance and Policy Development and Review Departments

(In consultation with other departments)

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Executive Summary

The broad principles of the comprehensive development strategy adopted by the international community in the Monterrey Consensus and expressed in the PRSP process provide the appropriate framework for the Fund's engagement in low-income member countries. This framework for fighting poverty and achieving the Millennium Development Goals (MDGs) is based on countries pursuing sound policies and good governance, combined with stronger international support. Following up on the broader discussion in August 2003, this paper presents alternative approaches as to how the Fund could best support low-income members and contribute to the intensified international effort toward the achievement of the MDGs through modifications in the instruments for, and the financing of, the Fund's future involvement in these member countries, recognizing their diverse circumstances.

Options on Instruments

The paper sets out alternatives to better address the differing needs of PRGF-eligible members:

- **To strengthen the efficient use of PRGF financing for members with continuing balance of payments needs**, staff proposes to (i) establish norms for access to PRGF resources under successive arrangements; and (ii) strengthen Fund policy and guidelines on the blended use of PRGF/GRA resources.

- **To assist countries facing limited balance of payments needs**, several alternatives are considered, in which staff (i) proposes guidelines on low-access PRGF arrangements; (ii) reviews the merits of (but does not propose) precautionary PRGFs; (iii) recommends an enhanced monitoring policy which provides close monitoring by the Fund and possible access to Fund resources in case of need; and (iv) considers the extension of post-program monitoring to PRGF-eligible countries.

- **To address the needs of members emerging from conflicts**, staff proposes to provide longer duration and more tapered access to emergency post-conflict assistance, allowing more time for these members to strengthen policy design and implementation capacity before embarking on adjustment programs that could be supported by PRGF arrangements.

- **To better respond to the adverse impact of exogenous shocks**, staff considers the following options: (i) principles for PRGF augmentation; (ii) subsidization of emergency assistance for natural disasters, as is currently the case with emergency post-conflict assistance; and (iii) a new facility within the PRGF Trust that would provide lending on PRGF terms but with the program duration and design features of a stand-by arrangement. Staff also discusses, but does not propose, subsidization of stand-by arrangements.

With Executive Directors' agreement, most of the options on instruments could be adopted in the context of this Board discussion. However, the enhanced monitoring policy, subsidized emergency assistance for natural disasters, and a new facility for stand-by-like financing within the PRGF and PRGF-HIPC Trust Instruments would require further Board consideration. Additional papers might also be needed if the Board decided to pursue precautionary PRGF arrangements or subsidization of stand-by arrangements.

Financing Requirements

The paper provides a preliminary assessment of the potential magnitude of the financial resources required to support the Fund's continued involvement in low-income countries. Staff's analysis indicates that:

- **For 2004–05**, the remaining period of the interim PRGF, available PRGF resources are likely sufficient to cover the projected requirements.

- **For 2006–10**, the main focus of this paper, staff believes that financing needs are such as to require a PRGF lending capacity of SDR 0.8–1.2 billion per year, broadly in line with the lending level in the recent past. This would likely involve a declining trend in commitments for "regular" PRGF operations, but a rising trend in lending in response to exogenous shocks.

- **Beyond 2010**, many factors would point to a decline in financing requirements, but, at this stage, it would be difficult to have confidence in projections. However, it will be very important for the Fund to maintain a significant financing capacity to address low-income members' balance of payments needs and in support of their efforts to achieve the MDGs by 2015. The precise options for using that financing capacity beyond 2010 will need to be examined closer to that time.

Financing Options

Staff considers pros and cons of various financing options and finds that:[1]

- Notwithstanding their respective merits, three options—**self-sustained PRGF**, **sun-setting PRGF**, and **grants**—that rely solely on the resources accumulating in the Reserve Account of the PRGF Trust would not provide sufficient financing to meet the projected annual requirements of SDR 0.8–1.2 billion in 2006–10.

- Options that involve using the Reserve Account resources for the **subsidization of the rate of charge on GRA credit under EFF-like arrangements** could accommodate the projected level of financing requirements. This approach would, however, represent a departure from the current funding structure of the Fund's concessional operations through trust arrangements, with various policy and financial implications.

- The option that allows **a self-sustained PRGF to begin operations in 2006 while supplementing its lending capacity by new bilateral loan resources** is most promising. This option would provide sufficient flexibility to meet the projected financing requirements of SDR 0.8–1.2 billion per year in 2006–10, while also providing for the continuation of self-sustained PRGF operations beyond 2010 at a significant level. Moreover, this option would maintain the current approach of conducting PRGF lending outside the GRA.

Following Board guidance on these issues, staff will return to the Board with follow-up papers and propose decisions for implementation, as necessary.

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[1] Exercising any of these options would require a decision by the Executive Board with an 85 percent majority of the total voting power and the consent of all 17 bilateral creditors to the Loan Account of the PRGF Trust.

Glossary of Abbreviations and Acronyms

CIRR	Commercial Interest Reference Rate
CCL	Contingent Credit Line
CFF	Compensatory Financing Facility
DAC	Development Assistance Committee
EFF	Extended Fund Facility
EPCA	Emergency Post-Conflict Assistance
ESAF	Enhanced Structural Adjustment Facility
EMP	Enhanced Monitoring Policy
GDP	Gross Domestic Product
GNP	Gross National Product
GRA	General Resources Account
HIPC	Heavily Indebted Poor Country
IBRD	International Bank for Reconstruction and Development
IDA	International Development Association
LOI	Letter of Intent
MDB	Multilateral Development Bank
MDGs	Millennium Development Goals
MEFP	Memorandum on Economic and Financial Policies
ODA	Official Development Assistance
PIN	Public Information Notice
PPM	Post-Program Monitoring
PRGF	Poverty Reduction and Growth Facility
PRSP	Poverty Reduction Strategy Paper
SAF	Structural Adjustment Facility
SDA	Special Disbursement Account
SDR	Special Drawing Right

I. INTRODUCTION

1. **On August 27, 2003, the Executive Board held a preliminary discussion on the role of the Fund in low-income member countries and how the Fund could best support these members and contribute to the intensified international effort towards the achievement of the Millennium Development Goals (MDGs).**[2] During the discussion, Executive Directors reaffirmed the need for the Fund to remain engaged in assisting low-income members over the long term, with the objective of facilitating the transition of these countries to market-based economies, such that they can reduce their dependence on official development assistance and exceptional financing and rely increasingly on private sources of external financing.[3] For most low-income members, this is a long-term objective. Directors agreed that, during this transition, the Fund would need to provide support, including through temporary financial assistance.

2. **Executive Directors viewed the Poverty Reduction Strategy Paper (PRSP) approach and the Monterrey Consensus as providing the appropriate framework for the Fund's engagement in low-income countries.** In this context, Directors underscored that the Fund should continue to focus on assisting these countries in (i) establishing macroeconomic frameworks that can support high sustained growth and poverty reduction, (ii) identifying and managing macroeconomic risks and vulnerabilities, and (iii) strengthening institutions and policies that underpin sound macroeconomic management. Directors acknowledged, however, the need for further consideration of how the Fund's instruments might be better tailored to the diverse needs of its low-income member countries.

3. **Executive Directors agreed that the Fund needs to continue to have the capacity to provide financing to low-income member countries on concessional terms**, **and they saw the PRGF as the principal tool for such financing.** A number of Directors, however, expressed concern that there would be a halving in projected annual lending capacity with the self-sustained PRGF starting in 2006, and considered that increased concessional resources would need to be mobilized. Some other Directors, however, stressed that this level of lending capacity would be adequate in light of the need to increase selectivity and effectiveness of PRGF-supported programs and the process of low-income country graduation. In light of the above, Directors requested a paper that would consider how the Fund's financing and instruments could best be restructured to better support these member countries, in light of their likely needs and changing circumstances.

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[2] *The Role of the Fund in Low-Income Member Countries Over the Medium Term* (SM/03/257, 7/22/03) and *Fund Assistance for Countries Facing Exogenous Shocks* (SM/03/288, 8/11/03).

[3] *Concluding Remarks by the Chair—Role of the Fund in Low-Income Member Countries Over the Medium Term, and Fund Assistance for Countries Facing Exogenous Shocks* (BUFF/03/164, 9/5/03). See also the *Communiqué of the International Monetary and Financial Committee of the Board of Governors of the International Monetary Fund*, 9/21/03.

4. **The present paper addresses the following questions:**

- How should existing instruments be adapted for those low-income members with a continuing need for Fund concessional resources, including through policies on PRGF access?

- How could the Fund facilitate low-income members' transition to a point where they can move beyond the Fund's concessional support, while allowing the Fund to continue to provide policy advice and technical assistance in the implementation of member countries' PRSPs and their efforts to achieve the MDGs?

- How could the Fund best assist those members that have just emerged from conflict in strengthening their institutional and administrative capacities to enable them to move quickly to PRGF-supported programs?

- How could the Fund make its financing more responsive to the impact of exogenous shocks and more helpful in the context of the effects of trade liberalization?

- In view of the need to continue the Fund's concessional lending to low-income member countries, and the general decline in market interest rates since the introduction of the PRGF, does the present funding structure of PRGF operations and lending terms remain appropriate?

- How should the Fund make PRGF lending more selective—a need stressed by Directors—in terms of PRGF eligibility, access, and graduation? How can the Fund best support macroeconomic policy-making and give signals to donors about current balance of payment needs? What role could low-access or precautionary PRGF arrangements play in this regard? How can the Fund best assist the more advanced members to gain access to private capital markets on appropriate terms?

- In light of the above, and taking into account country-specific circumstances, what level of PRGF lending capacity would be appropriate over the medium and long term?

- What options might be available for financing the continuation of the Fund's concessional operations in the coming years?

5. **This paper is one in a series to address various aspects of the Fund's role in low-income members arising out of the August 2003 discussion**. The work program emanating from that discussion is quite large. The present work on lending instruments and financing will be supplemented, in the course of 2004, by papers on PRGF program design as well as the annual PRSP progress report. The Independent Evaluation Office is also conducting a study of the PRSP and PRGF, which is likely to be discussed by the Board. Together, these

efforts will address the various modalities and content of PRSPs, their relation to Fund financial support, and the content of Fund-supported programs in low-income countries.

6. **A second critical area of work is debt sustainability and the enhanced HIPC Initiative.** The Board has recently considered a joint paper on debt sustainability, and work will continue consistent with that discussion. In addition, the Bank and Fund will need to jointly decide the correct course of action given that the **HIPC Initiative sunset clause** is due to take effect at end-2004. Staffs of the two institutions are currently considering the options available to address the problems presented by the sunset clause, in particular what would be done about countries whose debt is unsustainable but have not yet qualified for HIPC initiative debt relief. Staff will present its work to the Boards during the summer of 2004.

7. **Other issues of relevance to low-income members** will be considered in the discussions of the Review of Bank-Fund Collaboration in Program Design and Conditionality, the Global Monitoring Report on the MDGs, and the papers on options for mobilizing financing for the MDGs. Finally, the Biennial Surveillance Review, *inter alia*, will consider the function and modalities of surveillance, including in low-income countries.

8. **This paper is structured as follows**. Section II discusses the rationale for and the nature of the continuation of the Fund's concessional operations. Section III reviews the funding structure and lending terms of its PRGF lending. Section IV considers how the Fund could strengthen its assistance to low-income members, including alternatives for refining or extending instruments to: (i) make more efficient use of PRGF financing, (ii) assist members with limited balance of payments needs, (iii) tailor its support for members emerging from conflict, and (iv) provide appropriate support to members facing shocks. Section V assesses the possible magnitude of resource requirements for the Fund's future PRGF operations, including the financing needed to address shocks. Section VI explores options for financing, including using resources accumulated in the Reserve Account of the PRGF Trust and, possibly, additional bilateral loan resources. The final section suggests issues for Board discussion.

II. General Considerations

A. Rationale for the Fund's Future Concessional Financing

9. **Many low-income member countries could continue to face considerable economic challenges for the foreseeable future**. During these members' transition to the point where their stable macroeconomic performance and growth will enable them to graduate from financial reliance on the Fund, the Fund will have a critical role to play in several areas:

- **First and foremost, these members need the Fund to continue helping them design and implement policies aimed at achieving sustainable growth and deep and durable poverty reduction.** While much progress has been made in many of the

PRGF-eligible countries to meet these objectives, growth and macroeconomic stability remain fragile, and progress in reducing poverty has been limited. An important part of the Fund's involvement can be of a non-financial nature, including close surveillance with a focus on the Fund's core areas of competence and technical assistance to strengthen the institutional capacity needed for sustainable growth.

- **Second, many low-income members will continue to face balance of payments financing needs in the coming years**. For these members, the Fund's financial involvement, underpinned by appropriately focused conditionality, can be a vital support for sound policies and strong performance. Associated with low policy-making capacity and narrow production bases, many low-income members face stagnating or declining exports, depressed imports, and unfavorable terms of trade. These would imply persistent and potentially large current account deficits in the medium to long term. At the same time, most low-income members have little recourse to private financing or have to borrow at a high cost. As the needed reforms take time to achieve adjustment without inordinately damaging growth, these members would have to continue to rely largely on official financing, including from the Fund, to meet their balance of payments needs.

- **Third, concessional Fund assistance is needed by many low-income members that cannot afford to borrow on General Resource Account (GRA) terms.** Real GDP growth rates in a number of these members, while improving, have remained low. If the growth rates for these countries continue to fall short of the rate of charge for GRA loans, such borrowing would risk a return to an unsustainable debt path, undoing the achievements of the enhanced HIPC Initiative. Moreover, GRA credit offers relatively short grace periods and maturities, thus requiring relatively quick repayments by borrowing members. Therefore, for many countries, grants or concessional loans are clearly required to close balance of payments financing gaps. For those countries, however, that have the capacity to absorb and service private market financing, GRA financing at standard terms would be appropriate.

- **Fourth, Fund financing will continue to play an important role as a signaling and catalytic device for low-income members.** Fund financial support could, therefore, help the member mobilize the necessary financing—preferably in the form of grants—from donors and other creditors.

B. Nature of the Fund's Support for Low-Income Members

10. **While low-income members share a common need to place growth and poverty reduction on a sound footing and to make progress utilizing the PRSP process for achievement of the MDGs, individual members face different policy challenges and financing needs:**

- Some low-income members, because of conflict or governance problems, need to focus first on efforts to strengthen administrative and institutional capacity so as to be able to design and implement reform programs that can be supported by PRGF arrangements.

- In a majority of cases, achieving macroeconomic stability and ensuring that debt burdens remain moderate are top priorities. For these countries, the Fund's concessional assistance can help meet their balance of payments needs and mobilize development resources from other creditors and donors.

- In other cases, substantial progress has been made in achieving macroeconomic stability. For these members, the challenge is to maintain prudent policies, sustain high growth, and reduce poverty. Ultimately, these members can strengthen their domestic revenue mobilization and gain access to private capital to a point that they no longer need to rely on donor financing. The Fund's main involvement in these cases will be in the area of policy advice and technical assistance, but it will also be called upon, in the meantime, to reassure the donor community of the soundness of policies. Fund policy advice through surveillance should be focused on mechanisms to enhance broad-based growth, and its financial involvement should aim to help the members correct temporary payment imbalances.

11. **Factors that influence these countries' need for the Fund's concessional financing may change over time**. For a decade and a half, the normal mode of Fund engagement with most low-income countries has been through successive arrangements under the PRGF and its predecessors. Members' protracted balance of payments problems and the advantages of the policy framework provided by PRGF arrangements have been major factors underlying this pattern of engagement. For many countries, these needs will likely persist in the medium and longer terms. For the HIPCs, the need for recurrent Paris Club debt rescheduling and progress toward HIPC Initiative completion points has also created demand for continued PRGF arrangements. However, the demand for PRGF arrangements by these members is likely to decline as HIPCs move beyond the completion point. Nevertheless, official donors have long required assurances of satisfactory macroeconomic policy implementation, provided by PRGF arrangements as a basis for their assistance, and this demand could increase as the PRSP process gains ground.

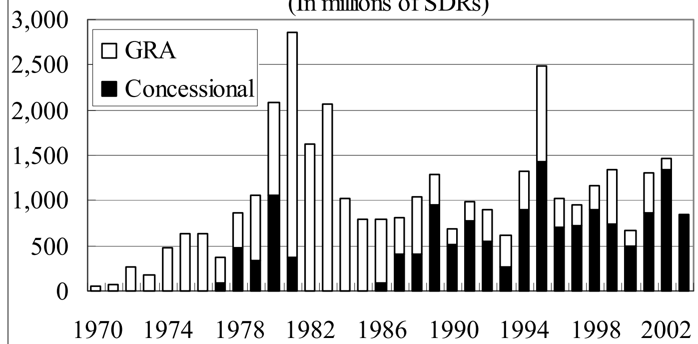
12. **As stressed by Executive Directors at the August 27, 2003 discussion, the PRGF should remain the key instrument to address the challenges facing low-income member countries.** The PRGF, while providing temporary balance of payments financing, allows the Fund to support the collaborative and country-driven PRSP approach as the framework for the Fund's engagement in low-income members. Nevertheless, in view of the relative scarcity of its concessional resources and the need to support only sound policy efforts by members, the Fund may need to be more selective in its lending to ensure that such resources are used productively by the member countries most in need. This might involve: (i) a more differentiated access policy, including a tighter link to balance of payments need and prolonged use of concessional resources; and (ii) a clearer policy on blending PRGF access with GRA resources under certain circumstances. These issues, among others, are discussed in greater detail below.

III. Review of the Fund's Concessional Financing

A. Funding Structure

13. **The Fund's concessional assistance to low-income countries dates back to the mid-1970s, but has only become the main source of financing for these countries since the inception of the Enhanced Structural Adjustment Facility (ESAF)** (Figure 1). To date, the Fund has extended concessional loans under the ESAF/PRGF to 56 members, amounting to a cumulative SDR 13 billion, at an average rate of just under SDR 1 billion a year. In addition, the Fund has committed SDR 1.8 billion in HIPC Initiative grant assistance to 27 members that have reached decision points, with SDR 1.1 billion already disbursed. The evolution of the Fund's concessional assistance to low-income members, including various lending instruments and sources of financing, is summarized in Box 1.

Figure 1. PRGF-Eligible Countries—GRA Purchases and Concessional Loan Disbursements 1/
(In millions of SDRs)



1/ Excluding GRA purchases by China and India.

14. **The Fund's concessional lending has been financed by contributions from member countries and the Fund itself (from resources in the Special Disbursement Account (SDA)), channeled through trusts separate from the Fund's GRA operations**.

- **During the mid-1970s and early 1980s**, financing for concessional operations—from the sale of 25 million ounces of gold—was channeled through the Trust Fund, and later, the Structural Adjustment Facility (SAF).

- **Both loan and subsidy resources for the ESAF** were provided mainly by bilateral creditors and contributors (including the Fund from SDA resources)[4] and were administered by the Fund, as Trustee of the ESAF Trust; the pool of these resources was enlarged in 1994 to allow a continuation of concessional lending. The ESAF was transformed into the PRGF in 1999, with a heightened focus on promoting growth and reducing poverty, and on the country-driven policy programs based on PRSPs.

[4] In 1993, the Fund contributed SDR 400 million to the Subsidy Account of the Trust (Decision No. 10531-(93/170) SAF, December 15, 1993 *Selected Decisions*, 27th Issue, page 413).

Box 1. Evolution of the Fund's Concessional Assistance

The Fund's concessional assistance to its members began in the mid-1970s and has expanded significantly in scope since then.

- In 1975, the Fund established **oil facilities** to provide temporary balance of payments financing to those members adversely affected by higher oil prices. The loan resources required were provided by several oil-producing countries, with subsidies being contributed by industrial and oil-producing countries. The rate of charge on such financing was 2 percent per annum.

- In 1976, a **Trust Fund** was established to continue to provide concessional financing to low-income members. Financing of the Trust Fund was made possible through the sale of 25 million ounces of the Fund's gold holdings during 1976–80. Of the amount generated, about US$3.3 billion was lent to a group of 55 countries. These loans offered a 5½ years grace period and were repayable in 10 years, at an interest rate of ½ percent per annum.

- In 1986, the **Structural Adjustment Facility (SAF)** was established to provide concessional financing to assist low-income members in addressing balance of payments financing needs arising from structural weaknesses. The SAF was financed by reflows of Trust Fund repayments, and its loans were extended on the same terms as the Trust Fund, but contained strengthened conditionality in the context of policy framework papers (PFPs) prepared jointly with the World Bank.

- The establishment of the **Enhanced Structural Adjustment Facility (ESAF**) in 1987 brought stricter conditionality to the Fund's concessional lending and offered higher access under three-year arrangements. Both ESAF loan and subsidy resources were provided mostly by member countries and administered by the ESAF Trust, with the Fund acting as Trustee. Like the SAF, the ESAF was intended initially to be a temporary facility—with the lending window open for about two years—but the cutoff date was repeatedly extended until the Trust was enlarged with the new bilateral loan and subsidy contributions in 1994.

- In the 1990s, in the context of a broad international effort, the Fund reoriented its concessional lending to focus more strongly on strengthening growth and reducing poverty. In response to a multifaceted crisis of unsustainable external debt, low or no growth, and widespread poverty, the Fund and the World Bank jointly launched the **HIPC Initiative** in 1996. The Fund provided HIPC Initiative assistance through grants that helped lower recipient countries' debt service repayments to the Fund.

- In 1999, the HIPC Initiative was further enhanced to provide faster, deeper, and broader debt relief to eligible countries. At about the same time, the Fund reestablished the ESAF as the **Poverty Reduction and Growth Facility (PRGF)** with a focus on reducing poverty and strengthening growth on the basis of country-owned poverty reduction strategies. Loan and subsidy resources for PRGF operations in 2002–05, **the so-called interim PRGF**, and grant resources needed for the HIPC Initiative assistance have been contributed by the Fund's membership and the Fund itself and administered through the PRGF and PRGF-HIPC Trusts.

- **Under the PRGF**, loan resources have continued to be provided by bilateral creditors, while subsidy resources (and HIPC Initiative grants) have been contributed by 94 member countries and the Fund itself. These resources have been administered under both the PRGF and PRGF-HIPC Trusts.

- **Beyond 2005**, it has been envisaged that the so-called self-sustained PRGF would be the basis for concessional lending, financed by resources accumulated in the Reserve Account of the PRGF Trust, also outside the GRA. The financing and key purposes of the Reserve Account, as well as the self-sustained PRGF, are described in Box 2. Other alternatives for possible sources of financing are discussed in Section VI.

15. **The appropriateness of funding the Fund's concessional lending through bilateral lending and contributions by members to a trust administered by the Fund rather than under the GRA, has been extensively discussed in the past.** In its consideration of continuing the Fund's concessional lending, the Executive Board, in the mid-1990s, examined various funding alternatives, including using GRA resources for financing the principal of PRGF-type assistance. Taking into account all the pros and cons, the Board agreed that the trust arrangement—relying on bilateral loan and subsidy resources—was the preferred mechanism for financing the continuation of PRGF operations.[5] This issue will be discussed in further detail in paragraphs 81–84.

B. Lending Terms

16. **At the time of establishing the ESAF in 1987, the Executive Board decided that disbursements under the ESAF should be provided under the same financial terms applying to loans under the SAF.** In particular, the Board agreed that the grace period and maturity of ESAF loans should be kept at five and a half and ten years, respectively, and that the interest rate be continued at 0.5 percent per annum, even though the amount of firmly committed subsidy resources was initially not sufficient. Directors also agreed that the Fund should seek additional subsidy resources necessary to maintain the concessional interest rate at 0.5 percent per annum but might also adjust the interest rate whenever available subsidy resources were judged insufficient.[6] These lending terms have remained in effect since the transformation of the ESAF into the PRGF in 1999. Table 1 provides a summary of lending terms under the various Fund facilities and policies.

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[5] See *Report by the Managing Director on Options for Financing a Continuation of the ESAF* (ICMS/Doc/46/96/9, 4/19/96) and *Concluding Remarks by the Acting Chairman—Financing the Fund's Participation in the HIPC and PRGF Initiatives—Update on the Status of Contributions and Loan Resources* (BUFF/00/149, 9/13/00).

[6] See *The Chairman's Summing Up of the Decision on the Enhancement of the Structural Adjustment Facility—Operational Arrangements* (EBM/87/171, 12/15/87).

Box 2. The Reserve Account of the PRGF Trust, Special Disbursement Account (SDA), and Self-Sustained PRGF

Reserve Account and SDA

- Under the terms of the PRGF Trust Instrument, PRGF operations are conducted through three separate accounts of the PRGF Trust: Loan, Subsidy, and Reserve Accounts. While the Loan and Subsidy Accounts were designed to finance principal and subsidy components of PRGF lending operations, respectively, the Reserve Account was established primarily to provide security to creditors of the Loan Account. The resources in the Reserve Account may also be used to meet temporary mismatches between repayments from borrowers and payments to creditors and to cover the Fund's costs of administering PRGF operations.

- The Reserve Account has been financed through transfers from the SDA of repayments and interest of the Trust Fund and the SAF (which were financed by net proceeds of gold sales in the late 1970s) and returns from investment of resources held in the Reserve Account. Thus, as the resources for the Reserve Account originated from the SDA, they are considered as the Fund's own resources. Apart from Reserve Account resources, the SDA contains net proceeds (SDR 2.226 billion) from off-market transactions in gold in 1999–2000. In November 2000, the Executive Board authorized the use of the interest income generated from these proceeds, up to SDR 1.76 billion (as needed), to finance the Fund's participation in the HIPC Initiative.

- As of end-2003, the outstanding balance in the Reserve Account amounted to SDR 3.1 billion, exceeding, by a factor of six, the projected repayment obligations falling due to PRGF Trust creditors through March 2004. Since the inception of the ESAF in 1987, the level of the balance in the Reserve Account has represented an average of 40 percent of outstanding claims to PRGF Trust creditors.

- Thus far, the record on PRGF repayments to the Loan Account has been strong. Out of 56 members that have made access to PRGF resources, only one member—Zimbabwe—has fallen into protracted arrears to the PRGF Trust since February 2001. As of end-2003, Zimbabwe's arrears to the PRGF Trust had necessitated repayments from the Reserve Account of about SDR 72 million to PRGF Trust creditors. The Reserve Account will be replenished when Zimbabwe settles its arrears to the PRGF Trust. Furthermore, the remaining overdue obligations to the Trust Fund (SDR 117 million) and the SAF (SDR 10 million) by Liberia, Somalia, and Sudan, once settled, will also be transferred to the Reserve Account.

Reserve Account and Self-Sustained PRGF

- It has been envisaged that, beyond the interim PRGF (2002–05), the continuation of the Fund's concessional lending would be conducted through a so-called self-sustained PRGF, which would be financed, on a revolving basis, from the SDA through retransfers of resources accumulating in the Reserve Account. This self-sustained PRGF framework was first discussed by the Executive Board in the mid-1990s. In October 1996, the Managing Director made a statement to Governors at the Annual Meetings that all Executive Directors had welcomed the agreement that would permit a self-sustained and, therefore, *de facto* permanent PRGF.

- Assuming that a self-sustained PRGF were launched in 2006, and on a basis of an assumed average interest rate of 5 percent per annum, the accumulating resources in the Reserve Account could sustain annual PRGF commitments of about SDR 660 million in perpetuity, while maintaining Reserve Account coverage for claims on the PRGF Trust at 40 percent. The projected lending capacity of the self-sustained PRGF will depend on the timing of the initiation of its operation, the assumed rate of return on the Reserve Account balance, and the possible reimbursement to the GRA of administrative expenses associated with PRGF operations (paragraphs 71–73).

Table 1. Terms of Fund Lending Facilities and Policies

<table>
<tr><th rowspan="2"></th><th rowspan="2">Access limit
(in percent of quota)</th><th rowspan="2">Charges/Interest</th><th colspan="3">Obligation schedule (expectation schedule in parentheses)</th></tr>
<tr><th>Grace
(in years)</th><th>Maturity
(in years)</th><th>Repurchase/
Repayment</th></tr>
<tr><td>First credit tranche</td><td>25</td><td>Basic rate</td><td rowspan="2">3 1/4
(2 1/4)</td><td rowspan="2">5
(4)</td><td rowspan="2">Quarterly</td></tr>
<tr><td>Credit tranches</td><td rowspan="2">Annual: 100
Cumulative: 300</td><td rowspan="2">Basic rate plus surcharge (100 basis points on amounts above 200 percent of quota; 200 basis points on amounts above 300 percent)</td></tr>
<tr><td>Extended Fund Facility</td><td>4 1/2
(4 1/2)</td><td>10
(7)</td><td>Semiannual</td></tr>
<tr><td>Supplemental Reserve Facility</td><td>Not specified</td><td>Basic rate plus surcharge (300 basis points, rising by 50 basis points a year after first disbursement and every 6 months thereafter to a maximum of 500 basis points)</td><td>2 1/2
(2)</td><td>3
(2 1/2)</td><td>Semiannual</td></tr>
<tr><td>Compensatory Financing Facility</td><td>55</td><td rowspan="2">Basic rate; the rate of charge on post-conflict emergency assistance for PRGF-eligible members is subsidized to 0.5 percent per annum from resources contributed to an administered account established for this purpose.</td><td>3 1/4
(2 1/4)</td><td>5
(4)</td><td rowspan="2">Quarterly</td></tr>
<tr><td>Emergency Assistance (Natural disasters and post-conflict)</td><td>Up to 50</td><td>3 1/4
(N/A)</td><td>5
(N/A)</td></tr>
<tr><td>Poverty Reduction and Growth Facility</td><td>For 3-year arrangements maximum limit:140 exceptional limit: 185</td><td>0.5 percent</td><td>5 1/2
(N/A)</td><td>10
(N/A)</td><td>Semiannual</td></tr>
</table>

17. **Notwithstanding the Executive Board's agreement on PRGF lending terms, questions have arisen in the past about their appropriateness for all low-income countries.** For instance, in the context of planning for the HIPC Initiative in the mid-1990s, suggestions were made to extend PRGF maturities for countries facing heavy debt-service burdens to multilateral financial institutions.[7] More recently, questions have been asked regarding the possibility of raising the grant element of PRGF loans to a higher level, say, 50 percent, as compared to an average of about 35 percent in the past.[8] It has been argued that increased concessionality of PRGF loans would be more consistent with the limited debt-servicing capacity of many low-income countries. Indeed, for some of the poorest or most highly-indebted, PRGF-eligible members, even highly concessional loans may not be consistent with their debt-servicing capacity. For these countries, financing should be in the form of grants as much as possible and some have suggested that PRGF assistance be made on grant terms. Paragraphs 74–76 below discuss further the possibility of the Fund's providing grants beyond 2005.

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[7] See *Continued Financing and Adaptation of the ESAF* (EBS/95/130, 08/04/95).

[8] At the present low market interest rates, the grant element of PRGF loans has fallen to about 27 percent, below the concessionality threshold of 35 percent. Indeed, even if the interest rate on PRGF loans were reduced to zero, the grant element would rise to only 30 percent.

18. **Issues that have arisen in past Executive Board discussions in connection with changing the lending terms of the PRGF include**: (i) the temporary use of concessional resources, and (ii) the implications for PRGF subsidy resources.[9]

- The use of PRGF resources with maturity extending beyond the current term of 10 years could give rise to questions regarding the **temporary use of PRGF resources** and, more generally, the nature of Fund assistance to low-income countries, as compared to long-term financing provided by development institutions. Indeed, with reference to the maturity structure of various Fund financing facilities, many Directors stressed the importance of maintaining the monetary character of the Fund.[10]

- Modifications of PRGF lending terms would have **implications for the level of loan and subsidy resources** needed and call into question the Fund's ability to continue to address the balance of payments needs of all PRGF-eligible countries. Without additional subsidy contributions, providing extended repayment terms would be at the cost of reduced lending capacity under the PRGF Trust (see also the discussion of the special case of grants in paragraphs 74–76 below).

19. **Raising the concessionality of loans under the envisaged self-sustained PRGF would also have significant resource implications, with adverse impact on future lending capacity**. For instance, at the current commercial interest reference rate (CIRR),[11] and assuming no change to the PRGF's grace period and concessional interest rate of 0.5 percent per annum, an increase in PRGF concessionality to, say, 50 percent, would require an extension of maturity to 29 years (or 20 years, using the historical average CIRR of about 5½ percent per annum). This would reduce the annual lending capacity of the self-sustained PRGF from the currently estimated level of SDR 660 million to SDR 400 million (or 500 million using the historical average CIRR).

20. **In view of the above implications, staff does not recommend changing current terms for PRGF lending.** Nevertheless, this has implications for the Fund's ability to provide financial support to some of its weakest members, for which it often recommends avoiding all but the most concessional borrowing. For these members, the needed level of concessionality of balance of payments support can be reached when the member's commitment to strong policies induces bilateral donors and MDBs to provide sufficient grants and other highly concessional support.

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[9] See, for example, *Continued Financing and Adaptation of the ESAF* (EBS/95/130, 8/4/95).

[10] *Summing Up by the Chairman—The Role of the Fund* (EBM/95/75, 8/2/95).

[11] The current 6-month SDR CIRR average rate is 4.04 percent, valid through February 2004.

IV. Strengthening the Fund's Support of Low-Income Members

21. **This section sets out alternative approaches to address better the differing needs of PRGF-eligible members.**[12] In this context, Box 3 summarizes the balance of payment problems of low-income members, and need as a condition for the use of PRGF resources.

- **For those members with continuing balance of payments needs**, access to PRGF resources should be sensitive to patterns of prolonged use and their access to other sources of financing.
- **For those members with limited need for Fund financing**, new options are proposed to provide these countries and donors with clear and credible policy assessments of macroeconomic performance outside the context of a standard Fund financial arrangement.
- **For those members emerging from conflict**, adjustments to the use of emergency post-conflict assistance (EPCA) may be needed in circumstances where a longer bridge to PRGF financing is desirable.
- **For those members experiencing adverse exogenous shocks**, there is a need to develop appropriately concessional means to address the impact of such shocks, both in the context of a PRGF arrangement and in circumstances where a three-year PRGF arrangement may not be called for.

A. Making More Efficient Use of PRGF Financing for Members with Continuing Balance of Payments Needs

22. **PRGF arrangements are likely to remain the primary vehicle of Fund financial support for PRGF-eligible members with continuing balance of payments needs and a remaining agenda of economic stabilization and structural reform.** Current lending policies and practice remain broadly applicable for these members. Nevertheless, there is scope for tighter criteria on access levels to ensure both more uniform treatment of members and more effective use of PRGF resources. Specifically, refinements of PRGF lending policies are proposed to provide: (i) access norms for successive PRGF arrangements to conserve scarce PRGF resources and reduce their prolonged use, and (ii) clearer guidelines on the use of PRGF/GRA blending to ensure more uniformity of treatment and to provide a less abrupt transition from concessional financing to non-concessional financing.

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[12] None of the alternatives in this paper for modifications to the Fund's instruments are expected to affect the framework for Fund collaboration with the World Bank or the division of responsibilities between the two institutions.

Box 3. Need As a Condition for the Use of PRGF Resources

In many low-income members, an underlying balance of payments problem does not necessarily manifest itself through the traditional indicators—namely, a balance of payments deficit or low international reserves—because the member might suppress their manifestation by, inter alia, constraining economic growth. These problems are expected to be addressed in part through changes in policies, including exchange rate adjustment, to achieve macroeconomic balance and enhance growth, supported by Fund or other financing, where appropriate.

The discussion of *Need as a Condition for the Use of Fund Resources* (SM/94/299) noted that a member must be experiencing a "protracted balance of payment problem" for approval of a three-year PRGF arrangement. The assessments for a protracted problem differ from the criteria used to determine the existence of present need for making a purchase from the Fund's general resources, and would be based on various external indicators rather than solely on the member's overall balance of payments position. In particular, past, present, and prospective external performance of the member should be examined, such as its export and import performance, terms of trade development, access to capital markets, cost of debt service, and foreign reserves. Medium-term financing gaps that the member might experience in its growth-oriented adjustment efforts should also be taken into consideration.

Protracted problems may not necessarily be associated with large current account deficits. For instance, an unsustainably large current account deficit may only reflect temporary factors and may reverse relatively quickly, given the country's external prospects and its ability to implement adjustment policies, and thus may not constitute a protracted balance of payment problem. Alternatively, a small current account deficit could be associated with severe constraints imposed by limited availability of external financing or foreign reserves rather than an absence of balance of payment needs. While the member must have a protracted balance of payments problem for the approval of a PRGF arrangement, it is not required to have a present need when it receives a disbursement under the PRGF, and it is possible that a disbursement will be made at a time when the member's need is still prospective. These requirements are different from those for the use of the Fund's general resources. A member's representation of need is not a condition for the approval of a stand-by or extended arrangement, while it must represent it has a need when a member actually requests a purchase under the stand-by or extended arrangement.

Access Norms

23. **Under the PRGF Trust Instrument, access under PRGF arrangements is determined on the basis of a set of general guidelines.** These include: a member's balance of payments need, the strength of its adjustment effort under the proposed PRGF-supported program, its outstanding use of Fund credit and the record of such use in the past, and ability to repay the Fund. The Executive Board has established a maximum limit for access in a PRGF arrangement of 140 percent of a member's quota (or 185 percent in exceptional circumstances).[13] Access levels under PRGF arrangements have involved a strong element of judgment. Table 2 indicates a few salient facts.

[13] Decision No. 8845-(88/61) ESAF, 4/20/88 and BUFF/99/01, (1/5/99). Staff is not proposing to modify these limits. The paper does, however, propose to update and extend access norms (i.e., expected average levels of access) which have been more influential in practice.

Table 2. Average Access under PRGF Arrangements
(In percent of quota)

	Number of countries	Average access	Range
First time	57	86	37–144
Second time	44	70	5–126
Third time	23	67	44–100
Fourth time	8	40	8–70
Fifth time	2	37	10–64
Memorandum items:			
Maximum limit 1/:		140	
Exceptional limit 1/:		185	

1/ Specified in Decision No. 8845-(88/61) ESAF, 4/20/98.

- **In a majority of cases,** where there is a clear balance of payments need and a sufficiently strong adjustment effort, the Fund has provided access around the norms, specified at 90 and 65 percent of quota, respectively, for first- and second-time users.[14] However, access levels have varied widely.

- **In exceptional situations**, access has been above the norm, including under arrangements immediately following arrears clearance, severe natural disasters, replacement of emergency post-conflict assistance, and other special considerations.

- On the other hand, **access has been below the norm in some cases**, for example, for some countries that have reached their enhanced HIPC Initiative completion point and have secured sustained inflows of donor grants, highly concessional loans, or both.

24. **The PRGF access norms for first- and second-time users have provided useful guidance without unduly constraining access in individual cases.** However, a large number of countries have now had more than two arrangements. While there is a general presumption of declining access in successive arrangements, no quantitative norms have been set to guide access for arrangements beyond second-time use. As most members requesting new PRGF arrangements have already had at least two such arrangements, it might be useful to extend access norms to third and subsequent arrangements (Table 3).

[14] These norms represent neither an entitlement nor a maximum, but are intended to provide general guidance for access decisions (BUFF/99/01). References to PRGF access limits and norms refer to total access over a three-year arrangement. Thus, the norm of 90 percent of quota for a first time user is roughly equivalent to average annual access of 30 percent of quota. In contrast to access limits for GRA facilities, there are no annual or cumulative access limits under the PRGF.

Table 3. Number of Successive PRGF Arrangements by Individual Member

	1988-90	1991-93	1994-96	1997-99	2000-01	2002-03
First time	14	15	16	7	2	3
Second time	0	2	14	11	12	5
Third time	0	0	2	8	9	4
Fourth time	0	0	0	1	1	6
Fifth time	0	0	0	0	0	2
Total:	14	17	32	27	24	20
Third time or higher (in percent)	0	0	6	33	42	60

25. **In line with current practice, PRGF access norms for third and subsequent arrangements could be tapered.** Setting norms that would indicate a gradual decline in expected access with successive PRGF arrangements would help to balance the interests of low-income member countries that have made infrequent use of the PRGF with the needs of those that have made relatively continuous use of the facility. Specifically, the current norms of 90 and 65 percent of quota for first and second arrangements could be extended to 55, 45, 35, and 25 percent of quota for third, fourth, fifth, and subsequent arrangements, respectively. As with current norms, these would be neither maxima nor entitlements.

PRGF/EFF Blend Arrangements[15]

26. **Blended arrangements—for low-income member countries with higher income levels or non-concessional financing alternatives—would help conserve scarce PRGF resources for those members that have limited access to non-concessional financing or for which such financing is inappropriate.** Some PRGF-eligible member countries already have access to substantial amounts of non-concessional credit or are close or above the indicative per capita income limits for IDA lending. While these emerging or pre-emerging market members often have substantial balance of payments needs, they are thus able to meet part of their needs through borrowing from external private capital markets or the "hard" windows of multilateral development banks or bilateral creditor agencies and have the capacity to service such assistance. A more systematic approach to PRGF/EFF blending would make the transition from concessional to non-concessional borrowing from the Fund less abrupt for those countries successfully moving toward middle-income, emerging market status with access to private capital markets.

[15] "Blend" arrangements entail having simultaneous PRGF and EFF arrangements in support of a single Fund-supported program and conditionality.

27. **The current criteria for blended access are imprecise and overlapping and would benefit from clarification** (Box 4)**.**[16] Under the current guidelines, PRGF access should be provided in a blend with GRA resources for members that: (i) have relatively good capacity to service new nonconcessional debt; (ii) have a high per capita income or have achieved a sustained improvement in per capita income with good prospects of graduating from IDA over the near term; (iii) have improved creditworthiness with possible access to nonconcessional international markets; (iv) have large quotas; or (v) are classified as IDA/IBRD blend countries by the World Bank. Many low-income countries satisfy at least one of these criteria, although few, if any, satisfy all of them. The diversity of these criteria for blending means they provide little real guidance.[17] For example, Bangladesh, the Democratic Republic of the Congo, and Zambia have the second, third, and fourth largest quotas respectively among the members that have borrowed from the PRGF and thus would meet the large quota criterion.[18] However, none of the three would have been good candidates for a PRGF/EFF blend, given that they all have per capita income well below half of the IDA operational cutoff and none has access to significant nonconcessional external financing. Similarly, some low-income countries have improved their creditworthiness, but their low income and debt-servicing capacity would make the accumulation of additional nonconcessional debt imprudent (e.g., Tanzania and Uganda).

28. **More structured criteria on blended access could provide a baseline for assessing comparable treatment while still allowing flexibility to address individual circumstances.** One alternative would be to parallel the World Bank's formal distinction

[16] The Executive Board provided for the possibility of blending PRGF resources with the Fund's general resources and has reaffirmed the role for PRGF blends on several occasions (Box 4). Most recently, the 1998 amendments to the PRGF architecture—to align the PRGF more closely with the EFF—were motivated in substantial part by a desire to simplify PRGF/EFF blending in the expectation of an increase in such arrangements (*Distilling the Lessons of the ESAF Reviews*, EBS/98/105, 6/16/98 and BUFF/98/62, 7/14/98). Nevertheless, while PRGF blends have been used in eight of 132 PRGF arrangements approved from 1988 through end-December 2003, there has been only one blend among the 52 PRGF arrangements approved since the 1998 amendments went into force.

[17] There have been shifts from PRGF/EFF blend to PRGF-only access and vice versa even for individual members. For example, Azerbaijan, Guyana, and Pakistan all had PRGF access blended with GRA access in the 1990s but had unblended PRGF access in arrangements approved in 2001 and 2002. Conversely, Sri Lanka had a PRGF-only arrangement in 1991 but a PRGF/EFF blend in 2003. For Azerbaijan, the decision to have the 1996 program supported by blend arrangement was based on prospective oil revenues, but the 2001 PRGF arrangement was not blended with EFF resources, even though the oil revenue was in more immediate prospect.

[18] Amongst eligible members so far under the PRGF, Pakistan has the largest quota. While it has access to substantial private market and non-concessional official borrowing and has had two PRGF/EFF blended arrangements in the past, it currently has a PRGF-only arrangement in place.

BOX 4. CRITERIA FOR BLENDED PRGF/GRA ACCESS

The Fund's policy and practice toward blending PRGF and GRA resources for PRGF-eligible members has been informed by several considerations set out in various Board discussions and policy documents. Specifically, PRGF access should be provided in a blend with GRA resources—preferably under an extended arrangement—to members that:

- Have relatively good capacity to service new nonconcessional debt;[1,2,3]
- Have high per capita income[2] or have achieved a sustained improvement in per capita income with good prospects of graduating from IDA over the near term;[3]
- Have improved creditworthiness with possible access to nonconcessional international markets;[2]
- Have large quotas;[3] or
- Are classified as IDA/IBRD blend countries by the World Bank.[3]

Typically, access to PRGF resources in blend cases is lower than in stand-alone PRGF arrangements.

Current guidance could be replaced by a *presumption* that PRGF resources would be provided in the context of a PRGF/EFF blend if either (i) the member's per capita income exceeded 75 percent of the prevailing IDA operational cutoff (currently US$875) or (ii) the member had significant recent or prospective borrowing from private capital markets or the "hard" windows of official bilateral and multilateral lenders. For total access (GRA and PRGF) within the range of the PRGF norms in percent of quota for successive arrangements; blended access would be expected to average 50 percent under each PRGF and EFF (i.e., PRGF access would be expected to average one half of the applicable norms for blends). Other factors equal, higher (or lower) overall access levels would be expected to have a higher ratio of EFF resources while lower access levels would be expected to have relatively higher ratios of PRGF resources. Recent borrowing could be assessed on the basis of IDA/IBRD blend status, amounts contracted in the preceding few years, or amounts provided for in the debt limits of recent Fund arrangements. Prospective borrowing could be assessed on the basis of the member's debt service capacity or other announced plans for external borrowing.

If neither of these conditions were met, there would be a *presumption* of access on pure PRGF terms. Also, the presumption on blended access would not apply to low access PRGF arrangements.

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[1] *Expansion of SAF/ESAF Trust Eligibility* (EBS/92/22, 2/11/92).
[2] *Enhanced Structural Adjustment Facility (ESAF) – Operational Guidelines for Staff* (SM/88/148, 7/12/88)
[3] *Continued Financing and Adaptation of the ESAF* (EBS/95/130, 8/4/95)

between IDA-only and IDA/IBRD blend members. IDA-only countries are the majority of low-income members, but fifteen are designated IDA/IBRD blend countries where assistance is provided through country-specific mixes of IDA and IBRD resources. A somewhat more flexible approach might be appropriate for the Fund, given the need to respond quickly to members' changing circumstances. Current guidance could be replaced by a presumption that a PRGF/EFF blend would be used if either (i) the member's per capita income exceeded 75 percent of the prevailing IDA operational cutoff (currently $875) or (ii) the member had recent or prospective medium- or long-term borrowing from private capital markets or the nonconcessional windows of official bilateral and multilateral lenders.[19] If neither of these conditions were met, there would be a presumption of access on pure PRGF terms. Exceptions for or against PRGF blending could be made in light of a member's special circumstances. Details of the proposal are in Box 4; illustrative country coverage is shown in Box 5.

BOX 5. PRGF/EFF BLENDS—POTENTIAL COVERAGE OF PROPOSED GUIDELINES
(World Bank estimates of 2002 U.S. dollar per capita incomes in parentheses)

PRGF-eligible Members with Per Capita Incomes Above 75 Percent of IDA Operational Cutoff

Albania (1,380)	Djibouti (900)	Maldives (2,090) [2]
Angola (660)	Dominica (3,180) [2,3]	St. Lucia (3,840) [2,3]
Armenia (790)	Georgia (720)	St. Vincent and Grenadines (2,820) [2,3]
Azerbaijan (710) [3]	Grenada (3,500) [2,3]	Samoa (1,420) [2]
Bolivia (900) [3]	Guyana (840)	Sri Lanka (840)
Cape Verde (1,290) [2]	Honduras (920)	Vanuatu (1,080) [2]
Congo, Rep. (700)	Kiribati (810) [2]	

Other PRGF-Eligible Members with Non-Concessional Borrowing

India[3]	Nigeria[3]	Pakistan[3]
Papua New Guinea[3]	Uzbekistan[3]	Vietnam
Zimbabwe[3 4]		

For reference, the World Bank blend countries were Azerbaijan, Bolivia, Bosnia and Herzegovina, Dominica, Grenada, India, Indonesia, Nigeria, Pakistan, Papua New Guinea, St. Lucia, St. Vincent and the Grenadines, Serbia and Montenegro, Uzbekistan, and Zimbabwe, as of July 31, 2003.

[1]The current IDA operational cutoff is a 2002 per capita GNP of $875.
[2]Small island economy exception for per capita income.
[3]IBRD/IDA blend country.
[4]Removed from the PRGF-eligibility list due to overdue obligations to the Fund.

B. Support of Members with Limited Balance of Payments Need

29. **Some low-income members have limited balance of payments financing needs.** Some early or mature stabilizers have sustained their adjustment policies to a point where they have little or no need for balance of payments financing. They also have ample international reserves and access to substantial resources from donors. For these members, substantial borrowing from the Fund is not needed in the near term, nor is this financing as concessional as other resources. Nevertheless, many of these members are still some distance away from graduating from PRGF eligibility, considering their income levels, ability to service non-concessional debt, and lack of access to private capital markets.

[19] Excluding limited "enclave" projects with government borrowing or guarantees for parastatal enterprise participation in commercial joint ventures.

30. **Close engagement with the Fund could, nevertheless, continue to benefit these members in several ways:**

- Despite their improved balance of payments positions, some of these members have not yet demonstrated a sustained track record of policy implementation. For these countries, Fund assistance and monitoring could still play an essential role in the design and implementation of macroeconomic and structural policies in support of the PRSP process.

- On the other hand, there may be countries where the macroeconomic situation has improved to the point where there is little or no balance of payments need but a substantial structural agenda.

- Low-income members with limited need for Fund resources may still need substantial grant or other highly concessional support from donors and official creditors. In cases where donors and creditors have looked to the Fund for assurance that the macroeconomic situation is stable and policy implementation is on track, the Fund's assessment may be requested as an important input into donors' own assessments.[20]

- Many low-income countries are potentially vulnerable to shocks and would benefit from a framework that facilitates quick access to Fund resources when needed.

31. **Four possible alternatives could enable the Fund to provide close monitoring and support for these member countries:**

- **Low-access PRGF arrangements** could be approved especially for those members where, despite the limited balance of payments need in the near-term, macroeconomic stability is not yet well established and the economy is vulnerable to exogenous shocks, or when a member finds the discipline of a formal Fund arrangement useful.

- Alternatively, **precautionary PRGF arrangements** could be considered, possibly with low access.

- For those members with a track record of sustained macroeconomic stability and successful program implementation, the Fund could assess a member's policies and support the PRSP process through a close-monitoring mechanism—**the proposed Enhanced Monitoring Policy**—to assure donors and creditors that policies and policy implementation are at least as strong as those associated with PRGF or upper

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[20] Fund assessments are already available in the context of surveillance through publication of PINs and staff reports and through ad hoc assessment letters or consultative group statements; however, some donors and international financial institutions may prefer a more structured assessment.

credit tranche conditionality, while providing access to Fund resources in case of need.

- Finally, **post-program monitoring**, currently applicable only to GRA credit, could be extended to members with substantial outstanding loans under the PRGF (100 percent of quota or more) that are exiting entirely from any form of PRGF or possible EMP relationship.

Each of these options is considered in turn.

Low-Access PRGF Arrangements

32. **Low-access PRGF arrangements would combine a familiar form of Fund endorsement of policies with a framework for quick augmentation should a significant balance of payment need emerge.** Thus, low-access arrangements would be most suitable for those member countries where MDBs and donors link their assistance to Fund-supported programs, or that are potentially vulnerable to shocks and might need quick access to financing without overburdening their debt capacity. To date, five such PRGF arrangements have been approved with three-year access of 15 percent of quota or less.[21] In each case, a PRGF arrangement was considered desirable to provide signals to donors and concessional lenders with assurance of Fund involvement in macroeconomic policy formulation and a clear and timely signal that the Fund considered macroeconomic policies to be on track.

33. **Some standardization of current practice with low-access PRGF arrangements could clarify the signal being sent to creditors, donors, and possibly markets.** A standardized access level in such circumstances could be set at 10 percent of quota over three years to help clarify that these arrangements are a standard Fund response to limited balance of payments needs rather than a sign that the Fund views the member's program as relatively weak. This would also avoid any implication that varied levels of low access represent differing Fund assessments of program strength or likely need. The clarity of the assessment could be bolstered by the inclusion of standard language in press releases for such arrangements explicitly noting the limited balance of payments need, rather than considerations of program strength, as the reason for the low access level.

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[21] As early as 1993, low access PRGF arrangements, with access at "very low levels," have been proposed for members with little balance of payments need but continuing need for structural reform (*ESAF Successor—Operational Modalities and Program Design Issues*, EBS/93/178, 11/16/93). However, no PRGF arrangement prior to 2002 had access below 35 percent of quota other than the PRGF portion of a PRGF/EFF blend with FYR Macedonia.

Precautionary PRGF Arrangements

34. **Precautionary PRGF arrangements could serve a similar purpose to low-access PRGF arrangements.** Precautionary PRGF arrangements have been considered as an alternative means of addressing the needs of low-income countries on at least two previous occasions.[22] Compared to low-access PRGF arrangements, precautionary PRGF arrangements that were never activated would send an even clearer signal of a strong balance of payments position than low-access PRGF arrangements. They would also have the advantage of conserving PRGF subsidy resources so long as the member did not draw.

35. **However, precautionary PRGF arrangements would have a number of shortcomings.** First, in light of the low interest rate and extended maturity of PRGF resources, there might be a temptation for the member to draw the resources, regardless of balance of payments developments. This would effectively turn the precautionary PRGF arrangement into a standard PRGF arrangement. Second, the PRGF Trust would need to set aside resources for precautionary PRGF arrangements and these would be unavailable to other low-income members. Third, PRGF arrangements cannot be approved for purely precautionary purposes, as a condition for the approval of a three-year arrangement under the PRGF is that the Fund must be satisfied that the member has a "protracted balance of payments problem."[23] A modification of the PRGF Trust instrument to permit precautionary arrangements could be approved by a majority of the votes cast by the Executive Board. However, in such circumstances, consistency with the Articles of Agreement would require the addition of a requirement for a representation of an actual balance of payments need for individual disbursements (as is the case under precautionary GRA arrangements). This would subject PRGF-eligible members to the more stringent test of an actual balance of payments need for the use of the Fund's concessional resources.[24]

36. **In light of the limited benefits, financial complications, and practical difficulties associated with the introduction of precautionary PRGF arrangements, staff prefers to continue and extend the use of low-access PRGF arrangements.** If low-income members

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[22] *ESAF Successor—Operational Modalities and Program Design Issues* (EBS/93/178); *Distilling the Lessons of the ESAF Reviews* (EBS/98/105, 6/16/98; BUFF/98/62, 7/14/98).

[23] *Need as a Condition for the Use of Fund Resources* (SM/94/299, 12/16/94), and *Distilling the Lessons of the ESAF Reviews* (EBS/98/105, 6/16/98 and BUFF/98/162, 7/14/98). See Box 3 for a summary of the earlier discussion.

[24] The shortcomings of precautionary PRGF arrangements in general apply to low-access precautionary PRGF arrangements, with the first two drawbacks partly reduced.

wish to signal the ability to forego PRGF disbursements entirely, this message might be more clearly conveyed through the Enhanced Monitoring Policy described below.[25]

Enhanced Monitoring Policy (EMP)

37. **The EMP was discussed in the context of the CCL review and consideration of possible alternatives** (SM/03/372, 11/12/03); it was envisaged to provide a framework for close Fund monitoring, without performance criteria and with a limited financial backstop in case of a need. While Directors generally felt that such a policy would not be effective in meeting the CCL's objectives, a number of Directors considered that an EMP might be a useful signaling device for low-income member countries making the transition to a pure surveillance relationship. It was also suggested that an instrument akin to the EMP (possibly without a direct link to Fund financing) might be a useful addition to the Fund's surveillance framework. Directors encouraged staff to explore this idea further.[26] While staff propose to develop the EMP as an instrument for use by any member, the discussion in this paper focuses on its use in support of low-income members. In the staff's view, the Fund's readiness to provide financing, when appropriate, under the EMP would enhance the credibility of the signal to donors.

38. **An EMP could be employed for low-income member countries that have sustained policy records and strong policy frameworks in place with no current balance of payments need, but which nonetheless would benefit from more intensive Fund monitoring and clearer signaling than provided by regular surveillance, as well as access to resources in case of need** (see annex).[27] As the financing provided under an EMP would be from the credit tranches, members should have adequate policy-implementation and debt-servicing capacity for the use of general resources before requesting an EMP. The EMP could be particularly attractive to members that are graduating from the use of Fund resources. These members might still have a substantial need for long-term development financing, despite having no current balance of payments need for Fund financing. However, with donors and creditors often conditioning disbursements on signals from Fund arrangements, the Fund could develop this alternative monitoring mechanism to provide a signal of Fund's endorsement of policies together with a limited financial backstop if a balance of payments need were to arise. This framework might also help those more advanced members gain access to private capital markets on appropriate terms. Consistent

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[25] If it chose to do so, a member could unilaterally refrain from requesting disbursements under a PRGF arrangement. This could be done without raising the legal complications noted above.

[26] *The Acting Chair's Summing Up—Completion of the Review of Contingent Credit Lines and Consideration of Some Possible Alternatives* (BUFF/03/213, 12/03/03).

[27] See *Review of the Contingent Credit Lines—Conclusions* (SM/03/372, 11/12/03) and *The Acting Chair's Summing Up—Completion of the Review of Contingent Credit Lines and Consideration of Some Possible Alternatives* (BUFF/03/213)

with its objective of providing an instrument for low-income members to make the transition to a pure surveillance relationship, an EMP would generally feature less detailed conditionality than a PRGF arrangement.

39. **The general features of the EMP for low-income members would parallel those discussed in the context of the CCL review, with a few modifications appropriate for low-income members**. First, the Fund will stand ready to provide access of 30 percent of quota in the credit tranches in the form of a single purchase to a member using the EMP if a balance of payments problem were to arise. This would be consistent with the intention to set the standard for policies under the EMP at a level consistent with upper credit tranche conditionality and assumes that the balance of payment need would be at least as large.[28] Second, as a low-income member, it would be expected to continue the PRSP process and prepare PRSP documents (although an up-to-date PRSP would not be a formal requirement for use of the EMP). Third, while the EMP discussed in the context of the CCL review proposed including both macroeconomic and structural targets in its program monitoring, the EMP for a low-income member would not generally be expected to feature many structural targets, reflecting the greater interest of donors in the Fund's assessment of macroeconomic policies for low-income members and the fact that the bulk of the structural agenda is likely to fall outside the Fund's core areas of expertise. While a few structural targets in the Fund's core areas of expertise could be included, countries with substantial structural agendas would generally not be good candidates for the EMP. The annex discusses the features of the EMP for low-income members in greater detail.

40. **With both the EMP and low-access PRGF arrangements focused on low-income members with limited balance of payments needs, the preferences of such members and of donors would also be key factors in determining the form of Fund engagement for the country.** Some donors and countries may favor a low-access PRGF arrangement for its familiar structure of formal performance criteria; others might place more emphasis on the positive signals about policy strength from an EMP relationship. Judgment would need to be made on a case-by-case basis. A crucial factor in this choice is the extent to which donors would accept the EMP as a sufficient basis for continuing their disbursements of development assistance. Surveillance-based alternatives to provide closer monitoring for member countries will be considered in the context of the upcoming biennial surveillance review.

[28] Most low-income members have no GRA purchases outstanding; thus, the entire first credit tranche would remain available even without the EMP. Given the smaller balance of payment needs and possibly less resilient debt profile of low-income members compared to more advanced economies, the 30 percent access corresponds to the lower end of the 30 to 50 percent of quota financing range proposed in the context of CCL review.

Post-Program Monitoring

41. **Post-program monitoring (PPM) could be extended to low-income countries exiting from traditional PRGF arrangements.**[29] While PPM was not intended to provide signals to donors and was not initially applied to users with outstanding PRGF resources, the Executive Board indicated that the issue of extending PPM to users of PRGF resources should be revisited.

42. **Given the high probability of successor arrangements under current usage patterns, the application of the PPM policy to users of PRGF resources would likely be limited.** As of end-November 2003, 22 members had outstanding PRGF loans or PRGF loans combined with GRA credit in excess of 100 percent of their quotas and would therefore potentially be subject to PPM after their Fund arrangements had expired. Of these, however, 18 had PRGF arrangements in place at end-November 2003, and the remaining four (Mali, Mozambique, Yemen, and Zambia) were discussing successor arrangements with Fund staff. Moreover, three of these four country teams produced ex post assessments in late 2003 covering much the same grounds as PPM reports, and the fourth (Yemen) will need to do so no later than in the context of the 2004 Article IV consultation mission. With the exception of Yemen, the most recent PRGF arrangement for these countries expired in the preceding half year.

43. **The relevance and value of PPM for PRGF resource users also needs to be assessed in light of a possible shift in the patterns of PRGF resource usage that might come about from adoption of some of the proposals in this paper.** If members exiting from traditional PRGF arrangements made use of either low-access PRGFs or the EMP, amortization of outstanding credit would likely bring many of them below the PPM access threshold before PPM would apply.[30] If, however, there were a more pronounced shift toward surveillance relationships without adoption of the proposed EMP, the number of members

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[29] The Fund introduced PPM in late 2000 for members with outstanding GRA credit in excess of 100 percent of quota at the expiration of their arrangements. PPM was designed to provide early warning of policies which could call into question a member's continued progress toward external viability and imperil repayment of outstanding Fund resources. PPM entails two annual consultation reports (one of which would normally be in the context of the Article IV consultation), as long as outstanding use of Fund resources is in excess of 100 percent of quota. While PPM is presumed when the 100 percent threshold is exceeded, it is not automatic; a decision would normally be taken at the time of the last review of the expiring arrangement. One consideration for not applying PPM in an individual case would be the high likelihood of a successor arrangement.

[30] Even where outstanding PRGF resources exceed 100 percent of quota, they generally do not exceed it by much. Of the 22 members noted above, only three had outstanding access as high as 150 percent of quota (Armenia, Kyrgyz Republic, and Tanzania at 153, 160, and 152 percent of quota, respectively).

potentially covered by PPM could be larger than the illustrative examples cited above.[31] PPM would also likely be most relevant in cases where a member with one or two recent, relatively high-access PRGF arrangements went into an extended period of poor policy performance. The application of PPM in such circumstances would be fully consistent with the intent of the policy.

44. **There is thus a case for extending PPM to outstanding PRGF credit of 100 percent of quota or more, given the scarce nature of PRGF resources and the need to maintain comparability of treatment across members.** While country coverage might be limited initially, and possibly even over the longer term, the need to safeguard Fund resources in the case of PRGF borrowers is no less than for GRA borrowers. Also, smaller absolute amounts of access under the PRGF than under GRA arrangements are a mirror of the greater scarcity of PRGF resources. Finally, the likely narrow country coverage would also imply that Fund staff resource costs from an extension of PPM to PRGF resource users would be small. Taking all of these considerations into account, the case for extending PPM to PRGF use seems as strong as for GRA use. Staff thus recommends such an extension.

C. Tailoring Fund Policies for Emergency Post-Conflict Assistance

45. **Emergency post-conflict assistance (EPCA) is intended to help members emerging from conflict as part of a broader international support effort.** It is intended to be a bridge to a PRGF arrangement for low-income members, but in some cases this has not been possible (Box 6). Low-income members emerging from conflict include some of the most capacity-constrained and economically fragile countries in the membership, and a bridge of a year or two may not be sufficient for developing the capacity to implement a medium-term program that could be supported by a Fund arrangement. However, a rapid transition to a Fund arrangement under the PRGF unlocks considerable benefits for the member. An arrangement can catalyze a shift in the form of assistance away from humanitarian needs towards reconstruction assistance and budget support, provide a basis for debt relief (an upper credit tranche or PRGF Fund arrangement is required for Paris Club rescheduling), or enable it to move forward under the enhanced HIPC Initiative. These factors may result in a member seeking to move to a Fund arrangement before it is ready, especially with respect to administrative capacity.

46. **The Executive Board opposed facilitating this transition by applying less stringent standards for PRGF arrangements and called for consideration of longer duration and more tapered access to EPCA to provide a sufficiently long bridge to the PRGF.**[32] Steps that might help achieve the right balance include:

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[31] Given that the EMP would imply closer monitoring of members than PPM, it would not be necessary to also apply PPM.

[32] *Concluding Remarks by the Chair—Role of the Fund in Low-Income Member Countries Over the Medium Term, and Fund Assistance for Countries Facing Exogenous Shocks* (BUFF/03/164).

- Amending the wording of the 1999 policy to indicate that a second tranche of 25 percent of quota could be made available when "the member is not in a position to implement a Fund arrangement after about a year **or more** under a program supported by emergency assistance" (new text in bold).

BOX 6. EMERGENCY POST-CONFLICT ASSISTANCE—HISTORY AND CURRENT POLICY

The goals of the Fund's emergency post-conflict assistance (EPCA) policy, as agreed in 1995, include reestablishing macroeconomic stability and rebuilding administrative and institutional capacity so that the countries using this assistance will be able to move to a PRGF or upper credit tranche arrangement within a relatively short time. In support of these efforts, the Fund is prepared to provide financial support normally of 25 percent of quota through outright purchases that can, where appropriate, be tranched into two or more separate purchases. Financial assistance requires a statement of economic policies and a quantified macroeconomic framework to the extent feasible. In practice, the average time spent under a post-conflict program has been about one year, and most of the countries have moved successfully to a PRGF or stand-by arrangement.

In 1999, Directors recognized that rebuilding could take longer than foreseen in the original policy. They agreed that when the member is not in a position to implement a Fund arrangement after about a year and when the rebuilding of capacity is slow, additional access of up to another 25 percent of quota could be approved where there is sufficient evidence of the authorities' commitment to reform and capacity to implement policies. There is an even stronger presumption that the second 25 percent of access would be tranched. Only one country (Sierra Leone) has sought access beyond the first 25 percent of quota, and this was in the somewhat special circumstances of a reemergence of fighting followed by a renewed post-conflict assistance effort.

While EPCA is provided on GRA terms, Directors have recognized that financial assistance on concessional terms would be more appropriate for low-income countries. In 2001, an administered account was set up at the Fund for donors to provide interest subsidies. In addition, in order to provide the emergency assistance resources on longer repayment terms than the GRA, Directors in 1999 supported the early replacement of GRA resources using resources subsequently provided under a PRGF arrangement. Individual decisions on access are based on balance of payments need and the strength of the program. However, the additional balance of payments need arising from the **EPCA** repurchases appears to have been fully reflected in PRGF access levels. While the average **EPCA** access level for the five members that made use of **EPCA** and moved to a subsequent PRGF was 23 percent of quota, average PRGF access for these five members averaged 27 percent above the applicable norms.

- Extending the length of EPCA-supported programs, in total, to as long as three years with as much as 50 percent of quota (although no more than 25 percent of quota per year). Where it is expected that it will take a long time to rebuild capacity, there could be a stronger presumption that access to both the first and second phases of

25 percent of quota would be divided into two (or more) purchases over a longer program period and perhaps tapered over time.[33]

- To help foster program implementation and to strengthen assurances to donors, supporting each purchase by a clear assessment of political commitment and the member's progress in increasing its ability to implement a program and rebuilding administrative capacity.[34]

- Consistent with a shift to more phased EPCA financing, extending the policy on safeguards assessments to cover members making use of EPCA resources.

- In cases where progress under the EPCA has proved to be insufficient for the member to move to a position where it is able to implement a PRGF arrangement, explicit consideration, in the next Article IV consultation following the expiration of the EPCA-supported program, of the appropriateness of (i) a staff-monitored program, or (ii) an explicit shift to a surveillance rather than program or pre-program relationship.

- For those that have achieved sufficient progress and are able to design and implement PRGF-supported programs, consideration should continue to be given to early replacement of emergency post-conflict assistance by concessional resources provided under the PRGF (by adjusting access appropriately). At an earlier discussion,[35] Executive Directors stressed that this would be an effective way of providing more financial support on appropriate terms to low-income post-conflict countries, as it would address both the concessionality and maturity issues.

D. Addressing Shocks

47. **Low-income members should have better and more clearly defined access to Fund financing to help them overcome exogenous shocks or other unanticipated balance of payments needs.** Key considerations for Fund financing for shocks include:

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[33] Of the nine countries that have received emergency post-conflict assistance, three made initial purchases of 25 percent of quota. The remaining 6 countries made purchases that were tranched into two segments, the smallest purchase being 10 per cent of quota.

[34] There also needs to be a more systematic evaluation of performance under the post-conflict program and of administrative and policy-implementation capacity before moving to a PRGF arrangement. The latter could involve a requirement that staff reports for requests for PRGF arrangements following on post-conflict assistance include an explicit staff assessment, drafted in consultation with the relevant technical assistance departments, of the country's capacity for undertaking a PRGF-supported program.

[35] See *Summing up by the Acting Chairman—Fund Assistance to Post-Conflict Countries* (BUFF/99/48, 04/09/99).

(i) providing financing in conjunction with programs that are appropriate to the type and duration of the shock and are supportive of the adjustment-financing mix; and
(ii) minimizing moral hazard and encouraging countries to reduce vulnerability (e.g., a Fund-supported program could incorporate measures to remove distortions to encourage more diversified production). While PRGF-eligible members can request Fund financing from GRA facilities, the practice has been to discourage low-income members' use of these facilities as inconsistent with their need for financing on concessional terms.

48. **The Executive Board asked for proposals to address the absence of concessional instruments other than the PRGF in the Fund's financial response to low-income members facing shocks.**[36] At the same time, it emphasized the need for these countries to prepare for shocks through advance planning, sufficient levels of international reserves, and economic diversification. Directors also saw the need for Fund staff to help mobilize donor assistance in response to shocks, particularly in the form of grants. However, the Executive Board also asked staff to propose guidelines for PRGF augmentation and to examine other options for Fund assistance to low-income members facing shocks. Alternatives to address the financial implications of shocks include: (i) PRGF augmentation where PRGF arrangements are already in place; (ii) possible additional subsidy resources for emergency assistance for natural disasters; and (iii) credit tranche access under stand-by arrangements or similar assistance for those low-income members that do not have a current PRGF arrangement. The possibility of using the Compensatory Financing Facility is discussed in a separate paper.

Principles for PRGF Augmentation

49. **PRGF augmentation is part of the appropriate response to most balance of payments shocks for members with PRGF arrangements in place and on track.** An existing PRGF arrangement provides a framework around which the policy response to the shock can be structured, including measures to ensure adequate expenditures to protect those most vulnerable to the adverse impacts of shocks. The additional financing necessitated by the shock can be incorporated into the existing PRGF arrangement in a rapid and straightforward manner with appropriate terms and conditionality.

50. **This current approach of addressing shocks through PRGF augmentation is broadly satisfactory but would benefit from greater clarity and systematization.**[37]

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[36] *Concluding Remarks by the Chair—Role of the Fund in Low-Income Member Countries Over the Medium Term, and Fund Assistance for Countries Facing Exogenous Shocks* (BUFF/03/164, 09/05/03).

[37] In recent years, PRGF augmentations have been the normal approach to addressing shocks in PRGF-eligible countries. Augmentations—the vast majority of which have been in response to an exogenous shock—have been approved for roughly one quarter of all PRGF arrangements as of end-August 2003. The median size of augmentations has been 10 percent of 12th Review
(continued)

Authorities' requests for augmentation have generally been met, but principles for augmentation have never been explicitly set out. Adopting principles for PRGF augmentation could, therefore, provide greater clarity to the policy and help ensure comparability of treatment across members. Proposed principles are set out in Box 7.

Use of Other Facilities by PRGF-eligible Members

51. **Assistance to low-income members without a financial arrangement that face shocks or other shorter-term balance of payments challenges needs a different approach.** About half the PRGF-eligible member countries do not have PRGF arrangements, and of those that do, some of the programs are off-track. While the low interest rate and associated concessionality of PRGF arrangements are appropriate for low-income members, a comprehensive, three-year PRGF arrangement may be both too long and too detailed to respond to the shorter-term financing needs associated with some shocks. Furthermore, stand-by arrangements or emergency assistance for natural disasters may be a more appropriate means of providing the policy framework and rapid financing needed to respond to shorter-term shocks. Emergency assistance can generally be disbursed quickly without conditionality, and reaching agreement on measures for a stand-by arrangement would typically be less time-consuming than for a new PRGF arrangement. However, both stand-by arrangements in the credit tranches and emergency assistance have a higher interest rate than a PRGF arrangement.

52. **The non-concessional interest rate for emergency assistance for natural disasters could be addressed by subsidizing the GRA rate of charge for PRGF-eligible members, as is currently done for EPCA.**[38] Since the inception of the PRGF, PRGF-eligible members have used emergency assistance for natural disasters on seven occasions, but only once for a member with a PRGF arrangement in place (an off-track PRGF arrangement with Malawi in August 2002). The subsidization of the interest rate could be handled in the same way subsidies for EPCA are handled, possibly by expanding both the resources and the coverage

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quotas, with a maximum and minimum of 37 percent and 3.7 percent of quota, respectively. Taking into account extensions of arrangements and periods where PRGF arrangements were off track, augmentations of on-track PRGF arrangements have been approved in slightly more than one year out of six. This frequency of augmentation is lower than some estimates of the frequency of adverse shocks in low-income members; estimates presented in *Fund Assistance for Countries Facing Exogenous Shocks* (SM/03/288, 8/11/03) put the likelihood of natural disasters and adverse commodity shocks at one per 2.5 years and one per 3.3 years, respectively. This discrepancy may reflect low-income members' access to grants or loans on more concessional terms than the PRGF.

[38] Countries meeting the criteria for blended access, as set out in Box 4, could receive a subsidy to cover only part of the difference between the GRA rate of charge and the PRGF 0.5 percent rate.

BOX 7. PRINCIPLES FOR PRGF AUGMENTATION

In the Board discussion on the Fund's assistance to countries experiencing exogenous shocks,[1] Directors took the view that members should prepare for shocks through adequate levels of reserves, economic diversification, and other means. At the same time, Fund staff should seek to alert donors and catalyze concessional assistance to low-income members facing shocks, preferably in the form of grants. Nevertheless, there remains a role for Fund financing. **For members that have a PRGF arrangement in place, the following general guidance is proposed:**

- **Fund staff should work with member country authorities and other institutions to assess the nature of the shock** and estimate the likely direct and indirect impacts of a shock on the balance of payments, growth and, to the extent possible, poverty. The mix of economic adjustment and financing (including from a member's international reserves) should reflect these assessments. Where the shock may be regarded as self-reversing, more financing and less adjustment could be appropriate. Where shocks may be more reasonably regarded as potentially persistent and possibly reflective of a trend, relatively more adjustment effort may be advisable, as additional financing could represent a short-term deferral of adjustment. However, financing may still be desirable to smooth the path of adjustment, particularly when sharp adjustment is likely to create strong indirect effects on growth and poverty. The determination of the financing-adjustment mix and the composition of financing will need to take into account debt sustainability considerations.

- **Fund staff should encourage some low-income members to seek (and donors to provide) more concessional resources than are available from Fund financing**, as highly concessional resources, including grants, are more appropriate for the poorest members experiencing shocks. However, should such resources not be sufficient to cover all financing needs, Fund staff should be prepared to recommend approval of PRGF augmentations to avoid overly disruptive adjustment, excessive drawdown of reserves, or external financing on terms less concessional than the PRGF (e.g., foreign commercial bank loans). This lending would, of course, be subject to an assessment of the member's capacity to repay.

- **For members with on-track PRGF-supported programs (with the partial exception of PRGF/EFF blends), PRGF augmentation is preferred to Fund financing from the GRA**. Nevertheless, low-income members remain potentially eligible for Emergency Assistance and Post-Conflict Emergency Assistance. As these forms of Fund financing have less stringent conditionality, members may borrow from these facilities in circumstances where policies would not be sufficient for PRGF, stand-by, or EFF arrangements.

[1] Based on *Fund Assistance for Countries Facing Exogenous Shocks* (SM/03/288, 8/11/03).

of that account or by setting up a second administered account. The Compensatory Financing Facility (CFF) also has the potential to provide financing for shocks, and a review of the CFF is being conducted in parallel with this paper (Box 8); it is not proposed that CFF purchases be subsidized.[39]

[39] For reasons discussed in the CFF Review paper, the stand-alone mode of CFF assistance is rarely likely to be appropriate; since the balance of payments assistance will normally need to be (continued)

53. **Emergency assistance for natural disasters would cover only a subset of shocks; for shocks related to commodity price shifts or other circumstances, stand-by arrangements in the credit tranches are the only practical alternative to a full, three-year PRGF arrangement.** Stand-by arrangements have been generally used by PRGF-eligible countries as a bridge to a PRGF arrangement and mostly for members with higher income levels or private market financing. For most PRGF-eligible members, staff has tended to discourage the use of stand-by arrangements in favor of PRGF arrangements, in light of the more favorable terms of the latter.

Box 8. Review of the Compensatory Financing Facility (CFF)

The current review of the instruments and financing for low-income members is taking place in parallel with a review of the CFF. The CFF was created in 1963 to help members cope with temporary export shortfalls caused by exogenous shocks. The facility was modified on a number of occasions, most recently in 2000, when it was recognized that most drawings under the CFF would need to be accompanied by economic adjustment to address preexisting balance of payments weaknesses. Thus, the Executive Board established that the CFF would be available either in the context of a Fund arrangement or in cases where a member's balance of payments position is deemed satisfactory apart from the temporary export shortfall or cereal import excess.

The staff paper on the review of the CFF explores the reasons for the lack of CFF use since its last modification and considers options for moving forward. The fact that the facility has not been used since it was last reviewed, despite several large, relevant shocks, raises questions about its usefulness. The CFF is available for both low- and middle-income members. Most middle-income countries have access to private financing or, if private financing is not available, they could seek support in the credit tranches under stand-by arrangements or, in some cases, under extended arrangements. Low-income members are relatively more affected by shocks and have less access to market financing. However, a new PRGF arrangement or augmentation of access under an ongoing PRGF arrangement would provide financing with more favorable maturities and interest rates. Furthermore, options presented in the current paper on instruments and financing for low-income members could further expand the available alternatives to the CFF.

While there is a case for eliminating the CFF, the paper concludes that the benefits of retaining it outweigh the costs at this time. Even if the nature of the underlying shock is often difficult to gauge *ex ante*, past experience, in particular since the last review, suggests that members are confronted from time to time with shocks that are clearly exogenous and temporary. For some members with otherwise strong balance of payments positions, the CFF offers the possibility of quick financing without the full conditionality attached to a Fund arrangement. Therefore, just as abolishing the CFF would seem to come at little cost to the Fund or its members, the same applies to keeping the CFF. Thus, the paper concludes that, while there are arguments in favor of eliminating the CFF, staff does not see this as an urgent matter and sees value in maintaining the facility in its current form pending development of the options presented in the current paper to deal with shocks affecting low-income countries. However, the paper proposes a further review of the CFF in three years time with the presumption that, unless there is clear demand for the CFF by then, staff will propose that the facility be abolished.

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associated with an adjustment program, stand-by or PRGF assistance can be tailored to meet the member's needs.

54. **Three options for the use of credit tranche access under stand-by arrangements or a new stand-by-like facility using PRGF resources could be considered for PRGF-eligible members**:

- Credit tranche access under stand-by arrangements on standard terms (current policy).

- Subsidized access to credit tranches under stand-by arrangements.

- A stand-by-like "window" within the PRGF and PRGF-HIPC Trusts using PRGF resources.

55. **First, those members with the capacity to service debt on GRA terms could be encouraged to make use of credit tranche access under stand-by arrangements at standard terms where the financing need is of short duration.** Bilateral donors could be encouraged, on a case-by-case basis, to offset the lack of concessionality by providing these members with additional grants.

56. **Second, the Fund could consider subsidizing the interest rate of credit tranche purchases under stand-by arrangements to low-income members with weak repayment capacity.** This could be done either through an administered account or a modification to the PRGF Trust Instrument to permit the use of PRGF resources for subsidization. However, there would be a number of problems with this option:

- Despite the subsidized interest rate, the level of concessionality would be considerably less than that under a PRGF arrangement, owing to the shorter grace period and maturity of credit tranche purchases. Indeed, in the current low interest rate environment, the additional concessionality from subsidizing the interest rate would be marginal, providing an additional grant element of only 6 percent.

- Reflecting the relatively short grace period and maturity and the resulting limited benefit from the subsidization of the rate of charge, subsidizing credit tranche purchases under stand-by arrangements would not materially ease the repayment burden on low-income members.

- If low-income members with large quotas were to request substantial access in the credit tranches under stand-by arrangements, it could lead to a substantial depletion of PRGF subsidy resources.

- Such subsidization would make the cost of implementing the presumption of early repurchase higher and might encourage requests to shift to the obligations schedule, even when the member's balance of payments had strengthened sufficiently.

- Subsidizing the interest rate through an administered account would require additional donor support to fund such an account. Alternatively, modifying the PRGF and PRGF-HIPC Trust Instruments to permit the Trusts to subsidize the rate of charge of credit tranche purchases under stand by arrangements made by PRGF eligible members would require a decision of the Executive Board adopted by an 85 percent of the total voting power, and the consent of all contributors of loan and subsidy resources to the PRGF and PRGF-HIPC Trusts.

57. **Third, the PRGF and PRGF-HIPC Trust Instruments could be modified to create an additional "window"—a separate facility under these Trusts—for lending on PRGF terms (0.5 percent interest rate, five-and-one half to ten year maturity) in arrangements with the program design features and duration of a stand-by arrangement.** This would permit lending at the level of concessionality associated with PRGF arrangements. It would, however, entail creating a new facility and substantial amendments to the PRGF and PRGF-HIPC Trust Instruments to permit financing for shorter-term adjustment needs and to modify the link between the PRGF Trust and the PRSP approach (discussed below). Also, as with other options involving a modification of the PRGF and PRGF-HIPC Trust Instruments, it would require a decision by the Executive Board adopted by an 85 percent majority of the total voting power and the consent of all creditors and contributors to the PRGF and PRGF-HIPC Trusts.

58. **Of these three alternatives, the PRGF "window" with a stand-by like variant of the PRGF would seem to be the best option to addressing shocks when no PRGF arrangement is already in place.** This would avoid the need for additional requests for donor resources to subsidize GRA lending and provide greater concessionality to PRGF-eligible countries than would be possible through subsidization of the interest rate on shorter maturity GRA facilities. Given the need for prompt agreement on assistance under this window, it might not be appropriate for there to be a requirement that an acceptable PRSP be in place, as is the case with the PRGF. Thus, it would be expected that members that might make use of this facility would continue the PRSP process and prepare PRSP documents. However, an up-to-date PRSP would not be a formal requirement. If the Executive Board believes one or more of these options worthy of further consideration, staff would prepare a further paper with more specific and detailed options, taking into account the Board's views.

59. **It must be recognized that for some of the weakest, most vulnerable members, none of the above alternatives would provide financing on terms that the member could afford.** Borrowing may not be the appropriate way to provide assistance following the destruction of productive capacity or to meet humanitarian needs, even when these are manifested in balance of payments shortfalls. Donors need to be ready with grants to meet problems of that sort. Executive Directors have cautioned that Fund disbursements are not always the right response, simply because they are quick-disbursing.[40] The Fund's role in

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[40] *Concluding Remarks by the Chair—Role of the Fund in Low-Income Member Countries Over the Medium Term, and Fund Assistance for Countries Facing Exogenous Shocks* (BUFF/03/164, 09/05/03).

such cases may be limited to drawing attention to the needs, cooperating with donors capable of providing grants, and helping to ensure that the assistance is utilized effectively.

V. Resource Requirements for the Continuation of PRGF Lending

60. **The resource requirements for the Fund's concessional assistance over the medium and longer term are subject to considerable uncertainty.** This section provides some preliminary estimates of the potential demand for resources, taking into account historical patterns of use of PRGF resources, available information provided by area departments, and member countries' projected gross balance of payments financing requirements,[41] and the potential financing needed to address the impact of exogenous shocks. In addition, as described below, the estimates presented in this section take into consideration the impact of various policy options that could affect the need for concessional resources subsequently, such as changes in access policy or changing financing responses for shocks.

61. **Based on these considerations, staff's preliminary estimates indicate that**:

- **For 2004 and 2005**, available loan and subsidy resources are able to support PRGF lending at about SDR 1.3 billion per annum, a level that is higher than in 2002–03 and is likely to be sufficient to meet estimated demand based upon updated country-specific projections by area departments, including for Sudan, after its arrears to the Fund are cleared following the conclusion of a peace agreement.

- **For 2006 to 2010**, various demand scenarios suggest that the aim should be to hold available a supply capacity in the range of SDR 0.8–1.2 billion per year, broadly consistent with the range of PRGF commitments over the last few years.[42]

- **Looking beyond 2010**—and bearing in mind the substantial uncertainty associated with the longer term—many factors would point more clearly to a decline in the demand for PRGF financing to below the annual levels in 2006–2010, while indicating that a significant capacity on the part of the Fund to supply PRGF resources will still be necessary to address low-income members' balance of payments needs and in support of their efforts to achieve the MDGs by 2015.

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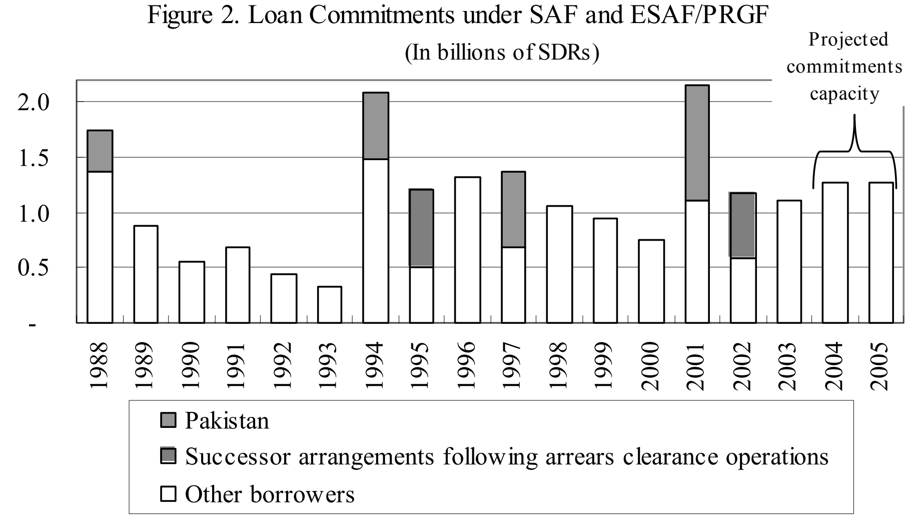
[41] This approach was used as the basis for projecting demand for PRGF resources for the period of 2002–05. For more information on this approach, see *Continued Financing and Adaptation of the ESAF* (EBS/95/130, 08/04/95).

[42] These estimates exclude commitments under initial PRGF arrangements immediately following the future clearance of arrears by Liberia and Somalia, but take into account additional concessional assistance needed under subsequent arrangements. Box 9 provides more detailed analysis on the resources required to address the arrears and debt problems of these protracted arrears cases.

A. Short-Term Prospects (2004–2005)

62. **Available PRGF loan resources under the PRGF Trust are estimated to be sufficient to finance PRGF lending at an annual level of about SDR 1.3 billion through end-2005 or early 2006, when these loan resources are exhausted.** As of end-2003, total loan resources provided by bilateral lenders to finance PRGF operations amounted to SDR 15.8 billion. With SDR 13.2 billion having been already committed to PRGF-eligible member countries, a remaining balance of SDR 2.6 billion can be used through 2005 or into early 2006, whenever available loan resources have been fully committed (Figure 2). The most recent area department projections indicate projected new commitments for 2004 on the order of SDR 1 billion, implying that an annual commitment capacity of about SDR 1.3 billion, based on the available loan resources, should be sufficient through end-2005 or into early 2006.

Figure 2. Loan Commitments under SAF and ESAF/PRGF
(In billions of SDRs)



63. **With peace negotiations possibly nearing agreement in Sudan, the issue of addressing Sudan's arrears and the associated PRGF and HIPC financing could soon be a matter of urgency.** No provision was made in funding the PRGF and PRGF-HIPC Trusts for the PRGF loan, subsidy, and HIPC grant resources that would be needed for Sudan (as well as Liberia and Somalia). Nevertheless, Pakistan's recently stated intention to not pursue a new PRGF arrangement following the expiration of the current arrangement at end-2004 and the recent or possible near-term expiration of PRGF arrangements with several members with substantial undisbursed balances could allow available PRGF loan and subsidy resources to cover the required resources for the PRGF portion (about SDR 0.6 billion and SDR 0.2 billion for loan and subsidy resources, respectively) of a blended PRGF/EFF arrangement for Sudan following arrears clearance. However, HIPC grant resources for Sudan of SDR 0.6–0.7 billion will still need to be mobilized. Box 9 provides more information on the exceptional financing needed to address the protracted arrears cases.

Box 9. Exceptional Financing for Protracted Arrears Cases

- **In funding the PRGF and PRGF-HIPC Trusts, no provision was made for PRGF loan, subsidy, and HIPC grant resources that would be needed for the protracted arrears cases—Liberia, Somalia, and Sudan—following the clearance of their arrears.**[1] These countries have been in arrears to the Fund since the mid-1980s, and the timing of possible arrears clearance is subject to considerable uncertainties. Nevertheless, the mobilization of resources for arrears clearance and HIPC Initiative assistance could become a matter of urgency. The prospects for an end to the civil conflict in Sudan (which has the lion's share of the overall arrears to the Fund) are better than at any time in the past two decades, and arrears clearance and debt relief would be a high priority in the immediate aftermath of the signing of a peace agreement. The fast-changing situation in Liberia, with a transition government already in place, could also place the issue of arrears clearance at the top of its agenda for normalizing relations with the Fund and the international community.

- **For Sudan alone**, an updated debt sustainability analysis indicates that the clearance of arrears to the Fund through a PRGF/EFF blended arrangement, followed by assistance under the HIPC Initiative soon thereafter, would require loan resources for the PRGF of SDR 0.6 billion and PRGF subsidy and HIPC grant resources of SDR 0.8–0.9 billion. Staff's current projections indicate that both loan and subsidy resources for the PRGF portion of a PRGF/EFF blend arrangement could be accommodated within the currently available resources. However, HIPC grant resources of SDR 0.6–0.7 billion would need to be mobilized.

- **Resource mobilization could be a major challenge in addressing the external debt and arrears problems of these countries.** While PRGF resources may be adequate for meeting the PRGF loan requirements for Sudan, separate and exceptional efforts will likely be needed to mobilize much of the resources required for arrears clearance and HIPC Initiative assistance for these cases. As in the past, bilateral contributions should be a significant source of funding for the PRGF-HIPC operations for these three countries.

- **Looking beyond, the Fund would need also to be prepared to provide further concessional assistance to these countries consistent with its policies and practices, including on program access**. The resources needed for this purpose should be planned for and need to be covered under the same PRGF financing envelope as other PRGF-eligible countries.

[1] Arrears to the Fund for these three cases totaled SDR 1.8 billion as of end-2003. See *Review of the Fund's Strategy on Overdue Financial Obligations* (EBS/03/118, 8/14/03) for more information on the protracted arrears cases.

B. Medium-Term Prospects (2006–2010)

64. **Over the medium and long term, a number of factors are likely to have offsetting impacts on the level of demand for the Fund's concessional resources.** Staff's preliminary analysis suggests that the demand for financing under the PRGF could decline, as the external positions of many PRGF-eligible countries strengthen further. At the same time,

application of the proposed guidelines on PRGF access (paragraphs 23 and 25) and greater selectivity in using PRGF resources would suggest a gradual decline in the aggregate use of PRGF resources. On the other hand, the demand for resources may be affected by the Fund's addressing the impact of exogenous shocks, including those related to trade liberalization,[43] assistance to Liberia, Somalia, and Sudan beyond arrears clearance, and potential demand from PRGF-eligible countries that have never made use of the PRGF. In any case, future demand for concessional resource requirements will hinge heavily on developments in those PRGF-eligible members with large quotas.

65. **Factors that are likely to contribute to a declining trend of demand for the Fund's concessional resources over time are**:

- **Further strengthening of PRGF-eligible countries' macroeconomic performance and external positions, including through the enhanced HIPC Initiative.** Many countries have already made significant progress in achieving macroeconomic stability and gaining steady financial support from donors and creditors in recent years, as evidenced, in part, by a significant strengthening in their balance of payments and reserve positions (Table 4). Looking ahead, by the completion of the HIPC Initiative, many affected countries are expected to have achieved stronger external/debt positions. While many of the post-completion point HIPCs would likely continue to face balance of payments needs, removal of the debt overhang could create a better footing for growth, and attract more donor support. For instance, of the nine countries that have reached their enhanced HIPC Initiative completion points to date, the four that have requested new PRGF arrangements have had low average access (Table 5).[44]

Table 4. PRGF-Eligible Countries–
Reserve-Import Coverage
(Number of countries) 1/

	1982	1992	2002
Less than 4 months	56	55	44
More than 4 months	9	17	31
Of which:			
More than 6 months	1	6	14

Sources: IFS and WEO.

1/ Excluding countries for which data are not available.

- **Possible graduation of a number of countries from PRGF eligibility, as their per capita incomes rise and their external positions further strengthen**. An illustrative scenario, based on continued strong growth rates in the coming years, indicates that close to 20 of the 77 PRGF-eligible countries could exceed the projected IDA per

[43] A paper on a Trade Integration Mechanism with implications for access to PRGF resources was issued separately.

[44] This could, however, reflect a selection bias in that the strongest performers were able to reach their HIPC completion points earlier.

capita income operational cutoff threshold (assumed to remain at the current level of US$875 in real terms) by 2015.[45] In addition, Pakistan, with one of the largest quotas among PRGF-eligible countries, has recently indicated that it will not seek further PRGF arrangements.[46] These 20 countries, plus Pakistan, account for about 20 percent of total disbursements of PRGF resources to date.

Table 5. Post-HIPC Cases–Access under New PRGF Arrangements
(In percent of quota)

Uganda	7.5
Mauritania	10
Tanzania	10
Burkina Faso	40
Average	**17**

- **Adoption of the proposed guidelines on PRGF access norms** (paragraphs 23 and 25), which could lead to a gradual decline in access under subsequent PRGF arrangements.

- **Any increase in bilateral aid,** which could also influence the demand for the Fund's concessional resources. Indications are that there will likely be an increase in official development assistance (ODA) flowing to the poorest members in response to the Monterrey Consensus.[47] Within this total, the share of grant assistance is expected to increase.

66. **While all of the above factors would suggest decreased demand for the Fund's concessional resources in the coming years, other considerations point to higher demand**:

- **While more open trade and financial systems in these countries could increase trend growth and diversify risks, it might also increase the frequency and intensity of exogenous shocks**. Financing for such adverse shocks could be provided through augmentation of existing PRGF arrangements or under new arrangements, depending on the nature of the shock, as discussed in paragraphs 47–59.[48]

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[45] Executive Board decisions on PRGF-eligibility decisions are not directly tied either to per capita income estimates or IDA-eligibility decisions. However, in practice, Fund decisions on PRGF eligibility have generally tended to follow trends in per capita income relative to the IDA operational cutoff and have taken IDA-eligibility decisions into account. It is assumed here that current policies and practices will continue in this regard.

[46] The most recent area department projections indicate that several additional countries would likely refrain from requesting further PRGF arrangements upon expiration of their current arrangements over the period 2004–06.

[47] ODA is expected to increase from 0.23 percent of DAC members' gross national income in 2002 to 0.29 percent in 2006.

[48] It is difficult at this point to project the impact of a stand-by-like window within the PRGF, should the Executive Board decide to pursue this alternative. The proposed Trade Integration Mechanism is also likely to increase the demand for PRGF resources.

- **After the other protracted arrears cases—Liberia and Somalia—clear their arrears, they will become eligible for concessional assistance**. While the initial PRGF arrangements associated with arrears clearance operations might need to be financed through additional resource mobilization efforts, subsequent financial assistance for these two cases and for Sudan would clearly need to be funded from available concessional resources, including using the resources accumulated in the PRGF Reserve Account.[49]

- **A number of PRGF-eligible countries have not made use of the PRGF in the past but could choose to do so in the future should protracted balance of payments needs arise**. These countries currently account for about 25 percent of the total quotas of all PRGF-eligible members.[50] While many of these countries are likely not to seek PRGF arrangements, the Fund needs to be prepared to provide financial support should their circumstances warrant.

67. **Based on the above considerations, the envisaged role of the Fund in low-income member countries would be likely to require resources for PRGF lending operations on the order of SDR 0.8–1.2 billion through 2010.** This reflects a declining tendency for "regular" PRGF operations, but an upward trend in financing for shocks within the PRGF resource envelope. That is, there would be a gradual reorientation away from successive PRGF arrangements toward more episodic financing, along the lines of the rest of the Fund membership. Of course, these projections are subject to considerable uncertainty and should be viewed as indicative only.

C. Beyond 2010

68. **Beyond 2010, the factors discussed above would suggest a more pronounced downward trend in financing requirements for Fund concessional operations.** The great uncertainty associated with long-term projections suggests that it is premature to speculate as to the precise demand for Fund financing for low-income members. However, it is clear that the need for such financing will still exist, both to address such members' balance of payments needs and in support of their efforts to achieve the MDGs.

69. **It will thus be important to plan the financial structure of the PRGF such that the Fund will have a significant capacity to extend its lending on concessional terms**

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[49] Should Zimbabwe clear its arrears and be declared PRGF-eligible, it might also request use of PRGF resources.

[50] These calculations exclude India, which, while PRGF-eligible, has agreed not to tap the Fund's concessional resources. If the calculations were to exclude Nigeria as well, the quota share would drop to only 12 percent.

beyond 2010. The precise options for using that financing capacity beyond 2010 will need to be examined closer to that time.

VI. Possible Sources of Financing

70. **This section reviews possible sources of financing to allow the Fund to continue its concessional assistance to PRGF-eligible members as described above.** Several options are discussed, three of which would involve financing solely from the Reserve Account of the PRGF Trust. While all options assume that resources in the Reserve Account would remain sufficient to cover 40 percent of total liabilities to the Loan Account of the PRGF Trust at all times,[51] each of these options has different implications regarding PRGF lending capacity, source of financing, and the length of operations (Table 6). Exercising any of these options would require—in addition to a decision by the Executive Board adopted by an 85 percent majority of the total voting power—the consent of all creditors of the Loan Account of the PRGF Trust.[52]

A. Financing Solely from the PRGF Reserve Account[53]

Self-Sustained PRGF

71. **It has been long envisaged that, beyond the current interim PRGF operations ending 2005 or early 2006, the Fund's concessional lending would be financed, on a revolving basis, from the resources accumulated in the Reserve Account of the PRGF Trust—the so called self-sustained PRGF** (Box 2). Current projections indicate that the

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[51] The assumption of Reserve Account coverage at the 40 percent level is based on historical precedent, rather than a legal requirement. This level is high by any risk management standard. Staff could, therefore, propose that it be lowered, but, as shown in Table 7, the impact on the lending capacity of the future PRGF from a lower coverage ratio is small.

[52] While the Fund has long envisaged that the continuation of the Fund's concessional operations beyond the interim PRGF could be financed from the resources accumulating in the Reserve Account of the PRGF Trust, a decision by the Executive Board (adopted by an 85 percent majority of the total voting power) would be needed to authorize the use of Reserve Account resources for this purpose, since such resources, which originated from net proceeds of gold sales in the late 1970s, are subject to the requirements of Article V, Section 12(f) of the Fund's Articles of Agreement. Moreover, since the primary purpose of the Reserve Account is to provide security to creditors to the Loan Account of the PRGF Trust, any use of Reserve Account resources, before they are sufficient to cover all liabilities of the PRGF Trust to those creditors, will require their consent (17 creditors).

[53] Projected financing capacities presented in these sections are based on the actual Reserve Account balance as of August 2003 and an assumed rate of return on investment of Reserve Account resources of 5 percent per annum in perpetuity.

Table 6. Summary of Financing Requirements and Options

Projected financing requirements: SDR 0.8-1.2 billion per year in 2006-10, somewhat lower thereafter.

Options	Key features
A. Reserve Account resources only	
Self-sustained PRGF	Both loans and subsidies are financed by resources of the Reserve Account on a revolving basis at an annual lending capacity of about SDR 660 million in perpetuity.
Grants	Grants are financed by resources of the Reserve Account; resources would be exhausted by 2011 if grants were provided at an annual level of SDR 660 million.
Sun-setting PRGF	Both loans and subsidies are financed by resources of the Reserve Account until a pre-set expiration or sunset date, with a maximum lending capacity of SDR 850 million per year in 2006-10, before declining to SDR 400 million per year thereafter until resources are largely depleted by 2015.
B. Self-sustained PRGF supplemented by new bilateral loans	
	Both loans and subsidies are financed by resources of the Reserve Account on a revolving basis at an annual lending capacity of close to SDR 500 million in perpetuity; additional requirements for PRGF loans, on the order of SDR 500 million per year in 2006-10 so as to meet projected financing requirements of SDR 0.8-1.2 billion per year, will be met by new bilateral loan resources, subsidized by the Reserve Account.
C. GRA financing subsidized by Reserve Account resources[1]	
	GRA resources are used to finance the principal component of EFF-like arrangements, so as to meet projected financing requirements of SDR 0.8-1.2 billion per year. Reserve Account resources are used to subsidize the GRA rate of charge down to 0.5 percent per annum, in line with the PRGF interest rate.

[1] A variant of this option would entail financing PRGF loans with resources in the Reserve Account and supplementing—to the extent needed to meet projected financing requirements of SDR 0.8-1.2 billion per year—with resources from the GRA to finance the principal component of EFF-like arrangements, with the GRA rate of charge lowered to 0.5 percent per annum through subsidies from Reserve Account resources.

self-sustained PRGF could maintain annual PRGF lending at about SDR 660 million in perpetuity, with Reserve Account coverage for claims on the PRGF Trust remaining at the historical level of 40 percent.

72. **This projected lending capacity is based on the assumption that the self-sustained facility will be launched in 2006 and that the rate of investment return on the**

balance in the Reserve Account will be maintained at 5 percent per annum in perpetuity. If, however, the assumed investment rate were lowered to 4 percent per year in perpetuity—the average SDR interest rate over the last ten years—the lending capacity of the self-sustained PRGF would fall to about SDR 600 million per year. On the other hand, if the Reserve Account coverage of outstanding loans were allowed to fall below its historical level, this would marginally raise the lending capacity. Table 7 illustrates the sensitivity of the projected lending levels under alternative interest rate and Reserve Account coverage levels.

Table 7. Sensitivity of Self-Sustained PRGF to Interest Rates and Reserve Account Coverage
(In millions of SDRs)

Reserve Account Coverage (in percent of outstanding claims)	(Interest rate in percent per annum)				
	4.0	4.5	5.0	5.5	6.0
	Self-Sustained PRGF lending capacity				
40	595	627	660	686	712
30	614	638	662	688	713
20	615	639	663	688	714
10	616	640	664	689	715

73. **These projections ignore the administrative expenses incurred by the Fund in carrying out PRGF operations.**[54] The legal requirements on the reimbursement of the GRA for such expenses differ in important aspects with respect to the interim PRGF and PRGF operations beyond the interim period (beyond end-2005 or early 2006; also see Box 10). The underlying reason is the different source of financing: the loan resources for the interim PRGF operations have been provided by bilateral contributors while those for the self-sustained operations will involve in whole or in part the Fund's own resources from the SDA. This distinction could have implications for future PRGF lending capacity.

- For the interim PRGF, **administrative expenses are not reimbursed to the GRA from the Reserve Account, owing to a decision taken by the Executive Board in 1999**.[55] As this decision is set to lapse in April 2004, reimbursement would begin at

[54] For all financing options considered in this section, this assumption is maintained.

[55] Through FY2004, the cost of administering PRGF operations, included in the administrative budget, is not reimbursed to the GRA (Decision 12065-(99/130)), and the resources thus saved are transferred to the PRGF-HIPC Trust as the Fund's share of contribution to the Trust. To avoid a higher regular rate of charge to recover this foregone income, the cost has been excluded from the target income, and charged as an offset to income from surcharges, if available.

**Box 10. Reimbursement of Administrative Expenses
Associated with Concessional Lending Operations**

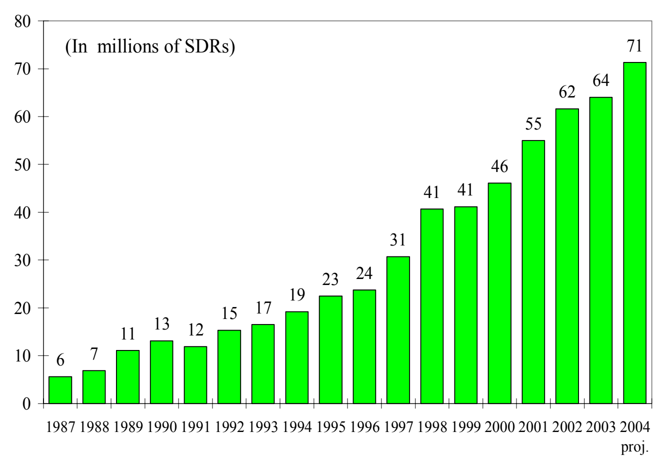
From the inception of the Trust Fund in 1976 until 1998, all administrative expenses associated with the Fund's concessional lending operations (including mission work, country review, preparation of Board papers, etc.) had been reimbursed to the GRA:

- The **Trust Fund Instrument** provided for the annual reimbursement of administrative costs from the Trust Fund to the GRA on the basis of "a reasonable estimate" of these expenses.

- As a successor facility, **the SAF Instrument contained** a similar provision.

- At end-1987, with the advent of the ESAF, the Executive Board decided that all administrative expenses associated with **SAF** and new **ESAF** operations should be reimbursed annually to the GRA from the SDA, with the corresponding transfers from the ESAF Trust Reserve Account to the SDA. This provision was no longer embedded into the ESAF Trust Instrument, but rather became a standalone Executive Board decision.

In 1998, with the initiation of **PRGF-HIPC** operations, the Board decided to forego reimbursement to the GRA of the expenses incurred in administering the PRGF operations but rather transfer the equivalent amount to the PRGF-HIPC Trust as a Fund contribution to the Trust. In the subsequent years, the Board adopted three separate annual decisions to this effect. At end-1999, the Board took a decision authorizing nonreimbursement and continued transfers of the foregone amount to the PRGF-HIPC Trust for the following four financial years through end-FY2004. Since 1998, the cumulative foregone reimbursements to the GRA and corresponding transfers to the PRGF-HIPC Trust amounted to SDR 362 million. The figure to the right illustrates the evolution of fiscal-year administrative expenses associated with PRGF operations and the implementation of the HIPC Initiative.



Implications for PRGF lending beyond the interim period

As discussed in the text, the projected level of the **self-sustained PRGF lending capacity beyond the interim period of 2002–05** is crucially dependent on the assumption that administrative expenses associated with lending operations would not be reimbursed to the GRA directly from the Reserve Account but from other resources accumulating in the SDA. Staff's preliminary analysis indicates that, with appropriately phased reimbursements, the projected investment income associated with resources currently in the SDA, apart from those in the Reserve Account, would likely be sufficient to cover the administrative costs associated with future PRGF lending operations.

However, should the reimbursement directly from the Reserve Account become necessary due to a shortage of other resources in the SDA, the annual lending capacity of the self-sustained PRGF could be significantly affected. Staff will revisit this issue in the forthcoming update paper on PRGF-HIPC financing in April 2004.

that time unless the Executive Board were to decide, by a majority of the votes cast, to defray these expenses from the GRA for the remaining interim PRGF period. As the Board's intent was not to reimburse the GRA for the administrative expenses related to interim PRGF operations, staff proposes to continue nonreimbursement through the life of the interim PRGF. If Executive Directors agree with this proposal, staff would prepare a draft decision to this effect for the adoption by the Executive Board in the forthcoming annual review (in April 2004) of the Fund's income position and rate of charge.

- **Any Board decision on the reimbursement of the GRA for the remaining interim period, however, would not be applicable to the administrative expenses of the self-sustained PRGF**. This would also not be applicable to any of the other options that would be financed by resources in the Reserve Account, as far as those expenses are attributed to the administration of resources contributed from the SDA.[56] Article V, Section 12(i), requires that the SDA reimburse the GRA for the expenses associated with the administration of the SDA, which includes the administration of resources in the Reserve Account, as the resources accumulating in the Reserve Account were originally transferred from the SDA.[57] Because the GRA could be reimbursed directly from the investment income accumulating in the SDA without drawing from the Reserve Account, such reimbursement may not have a significant impact on the lending capacity of the self-sustained PRGF. Staff's preliminary estimates indicate that, with appropriately phased reimbursements to the GRA, the projected investment income associated with resources currently in the SDA, apart from those in the Reserve Account, might be sufficient to cover the potential administrative costs associated with future PRGF lending operations. Reflecting the Executive Board discussion of this paper, staff will return to this issue in a follow-up paper.

Grants

74. **This option—which would use Reserve Account resources to provide grants, rather than loans, to PRGF-eligible members—is attractive in a number of respects.** Grant financing would address the problem of the limited capacity in many low-income countries to take on new borrowing, even of a concessional nature, and would ensure that the Fund would not contribute to any future debt sustainability problems in capacity-constrained low-income members. Grants would be particularly appropriate for those low-income

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[56] For the option which combines new bilateral loan resources with the self-sustained PRGF, the Executive Board has discretion in deciding whether the GRA should be reimbursed for the administrative expenses associated with that part of the lending financed by new bilateral loans.

[57] Article V, Section 12(i) states that the GRA shall be reimbursed "from time to time" for administrative expenses of the SDA based on a "reasonable" estimate of such expenses, implying flexibility in the pattern of reimbursement.

members which suffer a severe exogenous shock. Moreover, in light of the low degree of concessionality of PRGF loans in the current low interest rate environment (as discussed in paragraph 19), the use of grants would avoid the seeming inconsistency of the Fund providing such loans in a context of PRGF program conditionality which prohibits or sharply limits the contracting of nonconcessional debt.

75. **A drawback of this option, however, is that the provision of grants at reasonable levels would quickly exhaust resources accumulating in the Reserve Account:**

- If grants were provided at SDR 660 million a year, in line with the projected lending capacity of the self-sustained PRGF but below the projected resource requirements of SDR 0.8–1.2 billion per annum in 2006–10, resources in the Reserve Account would be largely exhausted by 2011 (with only a residual financing capacity thereafter).

- If grants were provided at SDR 300 million per year and supplemented with PRGF loans of SDR 300 million per year, Reserve Account resources would be exhausted by 2017.

- If the annual level of grants is set at about SDR 200 million, grant operations could continue indefinitely, but such a low level would mean that balance of payments assistance to low-income members would be primarily symbolic in nature.

76. **Other considerations might also be viewed as arguments against this option.** With resources even more severely limited under this option (and simultaneously more attractive to eligible members), a reduction in the PRGF eligibility list would likely be needed, an especially difficult task in light of projected needs of low-income member countries. Political pressures (particularly if motivated in part by humanitarian aims) could be more intense in support of a member's request for grant assistance, even in the face of weak policies by the member to address its problems. Grant financing by the Fund could also be viewed as blurring the line of responsibilities between the Fund as a monetary institution and that of multilateral development banks providing development finance. The Fund's flexibility to respond to low-income members' unanticipated balance of payments financing needs would also be substantially lessened; as a result, low-income members might have to request resources on GRA terms, which, contrary to the intention of grant financing, would add to their debt burden.[58] Finally, it is debatable whether grants would have the same impact as loans in catalyzing financing from other donors/creditors, as the Fund would no longer be seen as having the same compelling interest in supporting those policies that ensure repayment of its loans.

[58] For example, if a large quota country, such as Pakistan, were to unexpectedly request assistance from the Fund in the future, the Fund would not be able to provide significant grants without preempting their use for other low-income countries, thus implying that such countries might request access to the GRA.

Sun-Setting PRGF

77. **Under this option, resources in the Reserve Account would be used to sustain PRGF operations until a pre-set expiration or sunset date.** The level of annual commitments would determine the "sunset" date, at which point the Reserve Account resources would be exhausted. If the expiration date were set at 2015 to coincide with the MDGs target date, an annual commitment level starting from SDR 850 million in 2006 through 2010, and then declining to SDR 400 million would largely exhaust Reserve Account resources by 2015. With the resources in the Reserve Account nearly depleted by that date, the Fund's concessional operations would be terminated. Of course, an earlier/later sunset date would allow for higher/lower annual commitment levels.

B. Self-Sustained PRGF Supplemented with Additional Bilateral Loans

78. **If, as concluded above, loan resources of about SDR 0.8–1.2 billion per year were required for concessional lending operations during 2006–2010, the previous three options would be unable to meet this level of commitments, while also ensuring the continuation of a financing capacity of the PRGF beyond 2010.** The option discussed here, however, would allow these financing needs to be met in 2006–10 by supplementing the self-sustained PRGF (based on Reserve Account resources) with mobilization of bilateral loan resources to top off the self-sustained facility. Under this option, Reserve Account resources would also be available at an annual financing capacity of close to SDR 500 million for PRGF operations beyond 2010 in perpetuity. However, the high degree of uncertainty associated with projections of financing needs beyond 2010 (although they are expected to decline relative to 2006–2010 for the reasons discussed above) would necessitate a review prior to 2010 in order to determine what financing capacity the PRGF should have beyond 2010 and for how long.

79. **Under this option, PRGF lending would first tap resources from the Reserve Account of close to SDR 500 million per year through 2010, continuing beyond 2010 at the same level on a sustained basis.**[59] Additional bilateral loan resources would be mobilized *ex ante* (on the order of SDR 2½ billion through 2010) to ensure that principal resources were sufficient to meet desired commitments. New bilateral loans would also be secured by the Reserve Account, as in the case for existing PRGF loans.

80. **This option would provide flexibility to supplement the lending capacity under the self-sustained PRGF.** While it would require the mobilization of loan resources from bilateral sources, the amount that needs to be mobilized would be only 16 percent of the amount to date. Moreover, the market-rate remuneration (at the six-month SDR interest rate)

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[59] This self-sustained lending capacity is lower under this option than under the pure self-sustained option of about SDR 660 million per year, since Reserve Account resources are needed to (i) subsidize the interest rate on additional bilateral loans down to 0.5 percent per annum; and (ii) extend the security coverage to include the additional loan resources.

for these loan resources and the minimal risk (with ample security coverage provided by the Reserve Account) should imply that mobilization would be relatively straightforward (see Table 8 for information on the bilateral creditors and the amounts provided to date to the PRGF Trust).

Table 8. Contributors of Loan Resources to the PRGF Trust since Inception in 1987
(In millions of SDRs)

	Loan commitment
Belgium	350.0
Canada	700.0
China	200.0
Denmark	100.0
Egypt	155.6
France	2,900.0
Germany	2,750.0
Italy	1,380.0
Japan	5,134.8
Korea	92.7
Netherlands	450.0
Norway	150.0
OPEC Fund for International Development	37.0
Spain	708.4
Switzerland	601.7
Subtotal	**15,710.2**
Associated Agreement - Saudi Fund for Development (SFD)	49.5
Total	**15,759.7**

C. Subsidizing GRA Financing

81. **During the Board discussion on August 27, 2003, some Executive Directors again raised the possibility of using the Fund's general resources for financing the principal of future PRGF-type operations.** That is, GRA resources (through EFF-like arrangements which would still require the preparation of a PRSP, for example) could be used to meet the projected financing requirements through 2010, without the need to mobilize additional bilateral loan resources. Reserve Account resources would provide the subsidy resources needed to lower the GRA rate of charge to 0.5 percent per year.[60] At a projected level of demand in a range of SDR 0.8–1.2 billion per year in 2006–10, Reserve Account resources, to be used as subsidies only, would last indefinitely.[61] Resource requirements and financing

[60] A variant of this option is described in footnote 1 of Table 6.

[61] While GRA lending does not require Reserve Account security coverage, this option could have implications for precautionary balances that would have to be carefully studied.

options for the period beyond 2010 would be reviewed before that time in light of experience.

82. **While this option would allow the Fund to accommodate the projected level of required resources of SDR 0.8–1.2 billion per year, previous Executive Board discussions indicated a preference for the continuation of the trust arrangement to the use of GRA resources for this purpose.** While a number of Executive Directors favored the GRA option, citing difficulties in mobilizing loan resources from bilateral contributors, some Directors were strongly opposed.[62] However, in the event that sufficient bilateral loan resources were not forthcoming, the Board suggested during these earlier discussions that the option of using the GRA to finance the principal of PRGF-type operations could be considered.[63]

83. **Those Directors who opposed the use of GRA resources on principle made the following points:**

- Tapping GRA resources for PRGF-type operations could be viewed as **compromising the Fund's role as a monetary institution**. In this regard, it could be argued that the monetary character of the Fund would be inconsistent with repeated financing for structural reform through GRA financing in support of the objectives of achieving sustainable growth and the reduction of poverty .

- Relatedly, the prospects for repeated use of GRA resources for assistance to support growth and poverty reduction objectives could seem **inconsistent with the revolving nature of Fund resources** and their nature as liquid reserves of the Fund's creditors. In this context, Directors expressed concerns that provision of concessional assistance in connection with the GRA could be seen as signaling that PRGF-type operations might have a permanent nature.[64]

- Using GRA resources for financing PRGF-type operations would **expose the Fund to higher credit risk**, with implications for additional measures to safeguard the Fund's

[62] In fact, Germany made its contribution to the PRGF-HIPC Trust dependent upon no use of the Fund's general resources for financing interim PRGF-type operations (EBS/00/188, 8/31/00).

[63] *Report by the Managing Director on Options for Financing a Continuation of the ESAF* (ICMS/Doc/46/96/9, 4/19/96), and *Concluding Remarks by the Acting Chairman—Financing the Fund's Participation in the HIPC and PRGF Initiatives—Update on the Status of Contributions and Loan Resources* (BUFF/00/149, 9/13/00).

[64] *Summing Up by the Chairman—Operational Modalities and Funding Alternatives for an ESAF Successor—Preliminary Considerations* (BUFF/93/15, 4/12/93).

financial position.[65] Directors were of the view that further extensive use of the GRA by low-income members could unduly increase the Fund's exposure to those countries.[66]

84. **In addition to the points raised by Directors, creation of a new facility within the GRA (i.e., a subsidized EFF-like arrangement) for PRGF-eligible members could open the door at a future time to higher access than possible under the PRGF.** This could ultimately boost the risk to the Fund's portfolio and undermine recipient countries' debt sustainability. Moreover, while a PRGF arrangement only requires that the member country have a protracted balance of payments need, access to the GRA (consistent with the requirements of Article V, Section 3(b) of the Fund's Articles of Agreement) would imply the more stringent test of an actual balance of payments problem to request drawing.

D. Conclusion

85. **In the staff's view, all taken together, the option which combines the self-sustained PRGF with additional bilateral loans deserves serious consideration.** This option would allow the self-sustained PRGF to begin operation in 2006, while providing sufficient resources to meet the projected financing requirements in 2006–10 and also significant resources beyond 2010. The options financed solely from the Reserve Account would not be capable of meeting the projected required lending capacity as described in the previous section.[67] In addition, either the sun-setting PRGF or grants option would effectively close the door on the Fund's future concessional operations by exhausting Reserve Account resources over the medium term. Of course, the recommended option is dependent on mobilizing additional loan resources, but this should not pose a major difficulty in view of the market interest rate return that the Fund provides on such loans, the security provided by the Reserve Account balance, and the international community's support for the Fund's continued involvement in low-income countries.

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[65] Although the operations of the PRGF Trust are not on the account of the Fund, the Fund, as Trustee, has provided, from the SDA, the resources for the Reserve Account of the Trust to provide the security to lenders. The Fund, on the other hand, would bear the credit risk directly under the subsidized GRA option without the cover provided by the Reserve Account, which could require an increase in the Fund's precautionary balances.

[66] See footnote 61.

[67] During the August 27, 2003 Board discussion, a few Executive Directors proposed that the lending capacity of the future PRGF be maintained at the current level in real terms until 2015. Based on an assumed discount rate of 5 percent, this would imply a commitment capacity of SDR 1.3 billion per year in 2010, rising to SDR 1.7 billion per year by 2015.

VII. Issues for Discussion

86. **As noted at the beginning, this paper is intended to provide an initial reflection on the instruments for and the financing of the Fund's future involvement in low-income member countries.** Informed by the Executive Board's discussion of this paper, the staff intends to return to the Board with follow-up papers, as necessary. In light of the information provided above, the paper poses the following issues for Directors to consider.

Alternatives on Instruments

87. **The paper discusses how the Fund could best support low-income members and contribute to the intensified international effort toward the achievement of the MDGs.** In this context, staff has proposed a number of options to: (i) make more efficient and better use of PRGF resources; (ii) address more effectively the needs of members with relatively strong balance of payments positions; (iii) facilitate the strengthening of institutional capacity of members emerging from conflict and help them adopt adjustment and reform programs that could be supported by PRGF arrangements; and (iv) assist members in better addressing the impact of exogenous shocks.

(a) **On more efficient use of PRGF financing**, do Directors agree that it would be appropriate to adopt the norms for access to PRGF resources under successive arrangements set out in the paper? Do Directors also agree that Fund policy and guidelines on the blended use of PRGF/GRA resources need to be strengthened as set out in Box 4?

(b) **Concerning how to assist countries facing limited balance of payments needs**, what are Directors' views on the proposed guidelines on low-access PRGF arrangements, precautionary PRGFs, the proposed enhanced monitoring policy and post-program monitoring?

(c) **For members emerging from conflict**, would it be appropriate to provide more time, but with access capped at 50 percent of quota, under the EPCA policy, so as to allow them to restore and strengthen policy design and implementation capacity before embarking on adjustment and reform programs that could be supported by PRGF arrangements?

(d) **To address better the impact of exogenous shocks**, do Directors agree that PRGF argumentation remains an effective tool, and that it would be appropriate to subsidize emergency assistance for natural disasters, as is done for emergency post-conflict assistance? Would it also be desirable to introduce a new facility within the PRGF Trust that could provide lending on PRGF terms but with the duration and program design features of a one- year stand-by arrangement?

Alternatives on Financing

88. **The paper provides a preliminary assessment of the potential magnitude of the financial resources required to support the Fund's continued involvement in low-income countries and describes pros and cons of various possible sources of financing.** Staff's analysis indicates that: (i) available PRGF resources are sufficient to cover the projected needs in 2004–05; (ii) for 2006–10 (the main focus of the discussion), new PRGF commitments could amount to SDR 0.8–1.2 billion per year, broadly in line with the recent trend; and (iii) beyond 2010, many factors point to a decline in the financing requirements, but the Fund will still need to maintain a significant financing capacity to address low-income members' balance of payments needs and in support of their efforts to achieve the MDGs by 2015.

89. **Among the financing options considered, staff supports a self-sustained PRGF supplemented with additional bilateral loans**. This option would provide sufficient flexibility to meet the projected financing requirements of SDR 0.8–1.2 billion per year in 2006–10, while also ensuring the continuation of self-sustained PRGF operations beyond 2010 at a significant level.

(a) **On the possible magnitude of resource needs in 2006–10**, recognizing the considerable uncertainty associated with such projections, do Directors agree that a commitment capacity on the order of SDR 0.8–1.2 billion annually would likely provide a reasonable basis for follow-up work?

(b) **On financing options**, do Directors agree that: (i) the three options that would rely solely on the Reserve Account resources—self-sustained PRGF, sun-setting PRGF, and grants—would be insufficient to meet the projected financing needs in 2006–10; (ii) using grants or the sun-setting option would be undesirable as it would effectively close the door on the Fund's future concessional operations by exhausting the available Reserve Account resources relatively quickly; and (iii) subsidizing EFF-like arrangements with PRGF-eligible countries would represent a departure from the current funding structure for the Fund's concessional operations through trust arrangements, with various policy and financial implications?

(c) **Do Directors agree with the staff's proposal to pursue the option that would allow a self-sustained PRGF to begin operations in 2006, while supplementing its lending capacity by new bilateral loans on the order of SDR 2½ billion for 2006–10?**

The Enhanced Monitoring Policy (EMP)

1. The Enhanced Monitoring Policy (EMP), as discussed in SM/03/372, would provide close Fund monitoring without formal performance criteria, and limited contingent financing in case of a need. While the EMP is intended for use by any member, the following discussion focuses primarily on its application to PRGF-eligible members. For low-income member countries with strong policy framework and sound external positions and that are making transition towards a pure surveillance relationship with the Fund, EMP would be available to provide unambiguous Fund signals to donors on the members' policy implementation, as well as give some financing assurance when need arises.

2. Low-income and other members using the EMP would have access to GRA financing in the form of a single purchase from the credit tranches. The financing provided under the EMP would be in the form of approval of an outright purchase and would not necessitate the approval of an arrangement. The purchase would be approved, if, at the time of the request: (i) the member is experiencing a balance of payments need at least as great as the amount requested, and (ii) the member is successfully implementing an economic reform program, endorsed by the Fund at the outset of the EMP, that effectively meets the standards of upper credit tranche conditionality. At the time of the endorsement, a specific amount would be agreed based on the member's potential balance of payments need. Consistent with the intention to set the standard for policies under the EMP at a level consistent with upper credit tranche conditionality and assuming that the balance of payments need is at least that large, 30 percent of quota would be the norm for the purchase for low-income members. The purchase is intended to provide the member with quick access to financial resources as a safety net. The availability of this contingent financing would also enhance the credibility of the signal to donors because of the Fund's financial commitment.

3. Program design and monitoring under the EMP would closely mirror that of PRGF or GRA arrangements. Low-income members would be expected to continue the PRSP process and prepare PRSP documents. There would be an initial assessment of the country's economic situation and policy stance before an EMP would be put in place. Members would agree to a medium-term macroeconomic framework, together with near-term targets on key macroeconomic variables for the next year. Reflecting donors' relatively greater interest in the Fund's assessment of macroeconomic policies, EMP monitoring would not generally feature many structural targets, and countries with a substantial structural agenda would generally not be considered good candidates for the EMP. As under a PRGF arrangement, economic developments and policy implementation would be monitored through quarterly comparisons of performance against quantitative targets and semi-annual Executive Board review. These targets would not constitute performance criteria (as there would be no commitment of resources) but would enable the authorities, the Fund, and the public to monitor progress in policy implementation, thereby providing unambiguous signals to donors. They would also facilitate a quick Fund response in the event of a request for purchase, or triggering consultations when there were serious deviations. Should there be substantive deviations from the economic targets, they could be brought to the attention of the Board, either at the time of the scheduled reviews or earlier if warranted.

4. If a balance of payment need arises, the member could request the purchase. Board approval of this request would be based on the member's record in implementing the program. If the member were performing within the parameters of its macroeconomic program at the time it requested the activation purchase and if its policies were judged to be adequate to the challenge facing the member, the presumption would be that the activation purchase would be made available immediately. If these conditions did not apply, then the Fund and the member would reassess the policies and agree on corrective actions before the first purchase could be made. While there would be a presumption that the Board would approve a request made by a qualifying member, a separate assessment (albeit a more abbreviated one) would be required.

5. Further purchases could be made in the context of a standard Fund financial arrangement. Access, phasing, and conditionality would be specified at the time of the activation or post-activation request for an arrangement and would depend on the type of arrangement (such as a regular PRGF arrangement, PRGF/EFF blend, or GRA facility). Policy discussions and additional commitments would normally focus on the specification of forward-looking policies needed to address the causes of the balance of payments need, and the policy framework would be extended to cover the full period of the arrangement.

6. Executive Board documentation and review under the EMP for low-income members would closely mirror that for PRGF arrangements. Low-income members would still be expected to continue the PRSP process, and a PRSP document would need to be endorsed by the Boards of the Fund and Bank, consistent with guidelines on their timing for PRGF arrangements. An up-to-date PRSP document would not be a requirement for the EMP; however, it would be needed in the event that a low-income member under the EMP developed a balance of payments need and would need to move to a PRGF arrangement or PRGF/EFF blend. Requests for an EMP, as well as subsequent requests for conclusion of reviews, should be made in documents similar to LOI/MEFPs, and reviews would be scheduled at approximately semiannual intervals. Staff reports would be prepared in support of Board discussions for these reviews, with a recommendation as to whether or not the review should be concluded. Given the key purpose of signaling through these arrangements, standards of presumed publication for Fund-supported program documentation would apply.

7. The Enhanced Monitoring Policy differs from the Enhanced Monitoring Procedure proposed early in the context of the signaling discussion in that the EMP proposed here entails a Fund-monitored program (i.e., the Executive Board would be as fully involved in the EMP as with a PRGF arrangement). In contrast to track-record staff-monitored programs, the EMP framework would be agreed only with strong performers and would entail policy commitments and implementation standards at least as high as those needed to justify Fund arrangements.